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By Ali Shalchi

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Gift vouchers and insolvency

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Contributing Authors
Lorraine Conway

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Summary

When you buy a gift voucher, you enter into a contract. You give the retailer money in exchange for a promise to give you an equivalent amount in physical products in the future.

Vouchers can become worthless if the retailer becomes insolvent, because they might not have any money to pay you back – but the exact outcome depends on the retailer's situation.

If the retailer goes into administration (and so tries to avoid collapse) it can continue to trade, but the administrator can and often will refuse to accept the voucher. If the retailer goes into liquidation (which closes it down) its assets will be distributed in accordance with a defined order of priority. Holders of gift vouchers rank as unsecured creditors, who are low on the list of priorities, so they often get little or nothing.

Similar concerns apply to other types of consumer prepayment. For example, a consumer may pay a cash deposit when ordering an expensive new sofa. If the business then goes into administration or liquidation, the consumer may not receive the sofa and may also lose their deposit.

If a consumer makes a prepayment of over £100 using a credit card, they may be able to get back their money from their lender. If they use a credit or debit card, they may be able to make a "chargeback" claim to do this. But if they use cash, cheque or bank transfer, their only option is likely to be to make a claim with the administrator or liquidator and hope there will be enough assets in the insolvent company to pay them back, but there rarely is.

In 2016 the Law Commission recommended making changes that would provide more protection to consumers. The Government responded in December 2018, noting that it would consult on new laws to protect Christmas savers and to change the rules on when property passes to consumers. But it rejected the Law Commission's proposal to move some consumer prepayments up the insolvency priority list.

1 Introduction

1.1 Gift vouchers and other consumer prepayments

When you buy a gift voucher, you enter into a contract. The contract is initially between the person who purchases the gift voucher and the company itself. But the benefit of the contract is transferred to the receiver of the gift.

Retailers usually set "terms and conditions" to the gift voucher which will form part of the contract. The terms often state that the gift voucher must be used within a specified period. When a gift voucher has expired a trader does not have to accept it, but they might choose to as a goodwill gesture.

According to trade body the UK Gift Card and Voucher Association, the gift card market was worth just under £7 billion in 2019, and is expected to grow by 24.7% by 2025.[1] Hundreds of millions of pounds' worth of gift vouchers expire unusued every year.[2]

Gift vouchers are a common type of consumer prepayment. Another is where consumers pay a cash deposit for bespoke goods (like new furniture).

1.2 The problem

High-profile retailer insolvencies have highlighted the lack of protection for consumers buying gift vouchers or other prepayments. For example, there were unused gift vouchers worth £4.7 million when the electrical chain Comet collapsed in December 2012.[3] Home furnishings retailer Paul Simon held £2.4 million in customer deposits when it went into administration in April 2014.[4]

When they become insolvent, many retailers enter administration. An administrator (a specialist insolvency practitioner) is appointed who will try to rescue the company. The administrator will decide whether to continue to

1 Gift Card & Voucher Association, Valuing the UK Gift Card Industry 2020, p4
2 ThisisMoney, How retailers rake in £300m from the gift cards that don't go on giving, 24 November 2018
3 Law Commission, "Consumer Prepayments on Retailer Insolvency", 14 July 2016
4 Ibid

accept consumer prepayments (like gift vouchers), depending on the financial state of the business.

For example, HMV's administrators initially stated that they would not accept gift vouchers. But after reviewing HMV's financial position they later announced that they would redeem vouchers at their full value.[5]

Insolvency law does not give consumers any special protection. If the retailer is liquidated (closed down), consumers are classed as unsecured creditors who will not receive anything until secured creditors (typically banks and investment funds) and preferential creditors (such as employees) have been fully paid what they are owed. They are near the back in a queue of creditors looking for their money back.

As a result, according to the Law Commission, in the event of a retailer's insolvency, returns to voucher holders (unsecured creditors) tend to be poor – often less than 1p in the pound. For example, in the case of the retailer JJB Sports' insolvency in 2012, the distribution to unsecured creditors was 0.34 pence in the pound, meaning that a consumer with a £100 claim received 34p.[6]

5 BBC News, "HMV will accept gift vouchers", 21 January 2013

6 Law Commission, "Consumer prepayments on retailer insolvency", consultation paper No.221, 18 June 2015

2 Administration

Administration is one of several insolvency processes that an insolvent retailer might go through.

The Enterprise Act 2002 sets out a hierarchy of objectives for the administrator of a company in administration:

Hierarchy of objectives of a company administration

- The first objective is to rescue the company as a "going concern" (i.e. with as much of its business intact as possible).
- If the business cannot be saved, the second objective is for the administrator try to achieve a better return for creditors (people owed money) than would be achieved in liquidation (if the business was immediately closed down). For example, a better return may result from trading on for a period whilst seeking to sell off the business or assets.
- Where neither of these objectives can be achieved, administration can also be used as a mechanism to sell off assets and distribute proceeds to creditors.

Frequently, administrators will attempt to sell the company's business as a "going concern" and then liquidate the company

Once a company is in administration it is protected - there is a moratorium (i.e. temporary suspension or freeze) on legal proceedings against the company (often referred to as "a protective cloak"). This means that a creditor (like a gift voucher holder) can't sue the company (without the administrator or court's permission).

This provides a "breathing space" during which the administrator is expected to assess the company's financial standing, arrange for the valuation of assets, and produce a proposal either to rescue the company or for the sale of the business and/or its assets.

Distribution to creditors

The administrator is required to act in the interests of creditors as a whole – not just consumers.

They must choose either to distribute the proceeds of sale of the company's assets directly to creditors or to transfer this function to a liquidator (if the company cannot be saved and so must be closed down). In either case, creditors are paid according to a strict order of priority.

Each class of creditor is paid in full before any distribution can be made to the next class. Consumers who have made prepayments rank as unsecured creditors, low down in the list of priority after fixed charge holders (like a bank with a mortgage over a building), the administrator's expenses, preferential debts (like certain wages owed to employees), and floating charge-holders (who have security over company assets which constantly change like stock).[7]

Even then, the consumer will rank pari passu (equal in right) to other unsecured creditors (like a supplier owed money), so they will share equally between them anything that is available to go to unsecured creditors.

In practice, this means that the holder of a gift voucher is likely to get little or nothing back.

[7] A "prescribed part" of floating charge assets is reserved to go to unsecured creditors, which is currently capped at £800,000

3 Treatment of vouchers and prepayments

The options available to a consumer depend on what they used to buy the voucher (or make the prepayment) in the first place.

3.1 Credit card

If a gift voucher was bought using a credit card, the person who bought the voucher (not the recipient) or who made the prepayment may be able to draw on the protection offered by section 75 of the Consumer Credit Act 1974.

To benefit from this protection, the purchase made must be between £100 and £30,000.

If so, the credit provider (usually the bank providing the credit card) will be jointly liable with the retailer, so even if the retailer goes insolvent it's possible to make a claim with the bank.

Many providers allow customers to submit a claim on their website or by phone.

3.2 Credit or debit card

If a gift voucher was bought using a credit, debit or prepaid card (such as a Visa, MasterCard or American Express card) the buyer of the voucher may have the benefit of a "chargeback" scheme. Chargeback can be used to reverse transactions in certain circumstances, such as where a retailer fails to deliver goods or services which have been paid for.

There is usually no minimum or maximum limit to the amount that can be claimed but, usually, a consumer must make a chargeback claim within 120 days of when they bought the goods or service.

The provision of chargeback schemes is not a legal requirement; it is part of the card issuer's terms and conditions. So there are no guarantees that a card provider will be able to get a customer's money back for them. The buyer should check the precise terms of their card provider's chargeback scheme for confirmation.

3.3 Cash, cheque or bank transfer

If the purchaser of the gift voucher paid in cash, cheque or bank transfer, they have no specific protection. They need to claim as an unsecured creditor with the administrator or liquidator of the insolvent retailer.

The Law Commission found that less well-off socio-economic groups were most likely to pay in cash, and therefore sustain the heaviest losses. Cash buyers lost around £8.5 million in MFI's insolvency in 2008 and £1.5 million following the insolvency of Homeform in 2011.[8] An analysis of cases by Citizens Advice found that the average amount lost in the cases reported to them was around £700.[9]

8 Law Commission, "Consumer Prepayments on Retailer Insolvency", 14 July 2016
9 Ibid

4 Calls for reform

In January 2013, Conservative MP Sir Tony Baldry called on the Government to consider changes to insolvency law, so that consumers who make prepayments or purchase gift vouchers are better protected.[10] He suggested that retailers should be required to keep monies raised from gift vouchers in a separate account.

On 12 February 2013, Labour MP Michael McCann introduced a Private Members' Bill (under the Ten Minute Rule), that would amend the order of priority in insolvency to make purchasers of gift vouchers preferential creditors. This would make them more likely to achieve higher returns. The Bill had its first reading in the House of Commons but failed to make any further progress.

4.1 Law Commission review

In September 2014, the Department for Business, Innovation and Skills (BIS)[11] asked the Law Commission to examine the protections given to consumer prepayments and to consider whether such protections should be strengthened.

The Law Commission published a consultation paper on 18 June 2015, "Consumer prepayments on retailer insolvency", in which it sought views on whether greater protection was needed for consumers.[12] Although various consumer groups called for a change to insolvency law, so that consumers who have made prepayments or hold gift vouchers are paid in priority to other creditors, the Law Commission provisionally concluded that this would not be practical or proportionate given the other interests involved, including those of employees, secured creditors and other unsecured creditors (such as suppliers).

The Law Commission also thought that forcing buinesses to safeguard prepayments (such as by requiring them to be held in a separate account) would impose an excessive regulatory burden on businesses.[13] Instead, it invited views on other options, including encouraging issuers of gift vouchers

[10] "HMV accused of theft over gift vouchers debacle', The Guardian, 16 January 2013

[11] now the Department for Business, Energy and Industrial Strategy

[12] Consumer prepayments on retailer insolvency", Law Commission consultation paper No.221, 18 June 2015

[13] Ibid

to implement protection voluntarily through trust arrangements or industry-led development of insurance products.

The Law Commission published its final report on 13 July 2016.[14] The report set out five recommendations to improve consumer protection:

- Giving the Government a power to require prepayments to be protected in sectors which pose a particular risk consumers.
- Requiring consumer payment schemes which operate as savings mechanisms (like paying for Christmas hampers in advance) to be protected (such as through insurance).
- Giving consumers more information about obtaining a refund through their debit or credit card issuer.
- Updating the rules on when ownership of goods transfers to be more favourable to consumers.
- Making a limited change to the insolvency hierarchy, for prepayments of £250 or more made in cash, cheque or bank transfer in the six months before insolvency. Consumers making such payments would be “bumped up” the insolvency hierarchy to be preferential rather than unsecured creditors, making it likely that they will get a better return.

Citizens Advice expressed support for the Law Commission’s proposal to make a limited change to the insolvency hierarchy. [15] However, R3 (the industry body for insolvency practitioners) was against it, arguing it would increase the complexity and cost of administering retail insolvencies and delay the time it would take to resolve such cases, to the detriment of all creditors.

Privileging some unsecured creditors would inevitably mean there is less available to go to the remaining unsecured creditors (like suppliers or consumers who made prepayments below £250).

[14] Law Commission, “Consumer Prepayments on Retailer Insolvency” (July 2016) Law Com No 368

[15] Department for BEIS, “Government Response: Law Commission Report on Consumer Prepayments on Retailer Insolvency – Government Response”, Department for Business, Energy & Industrial Strategy, December 2018

4.2 Government response

In its formal response, published in December 2018, the Government said it would consult on new laws to protect Christmas savers and to change the rules on when property passes to consumers.

It accepted all the Law Commission's recommendations except for the proposal that a change be made to the insolvency hierarchy to prefer some consumer claims:

> The government recognises the concerns when individual consumers may lose money in an insolvency situation. However, in its view this recommendation could increase the cost of capital, harm enterprise and lead to calls for preferential status for other groups of creditors which would adversely affect the amount available to other unsecured creditors, which would lead to far greater losses to the wider economy. The Law Commission suggest that there are value judgments to made when considering the insolvency hierarchy and set the measure out as an option should the government feel the need to act. The government has decided not to pursue this measure.[16]

In a Parliamentary Question in June 2020, Labour MP Ian Mearns asked about the Government's plans to "increase the protections afforded to those who buy gift cards for businesses in cash…in circumstances where businesses enter administration." Business Minister Paul Scully responded that the Government "has worked with the industry and consumer groups to publish better guidance" but did not mention plans to publish a consultation or bring forward legislation to implement any of the Law Commission's recommendations.[17]

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16 Ibid

17 Written Question UIN 59213, tabled on 12 June 2020

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