



Office of the Secretary

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

August 14, 2007

David A. Balto, Esq.
1350 I Street, NW
Washington, DC 20005

Re: *In the Matter of Kmart Corporation, Kmart Services Corporation, and Kmart Promotions, LLC, corporations, FTC File No. 062 3088*

Dear Mr. Balto:

Thank you for the comments you submitted on behalf of the Consumer Federation of America, Consumers Union, and US PIRG regarding the above-referenced matter. Your comments were placed on the public record pursuant to Section 2.34 of the Commission's Rules of Practice, 16 C.F.R. § 2.34, and were given serious consideration by the Commission.

Your comments address the case against Kmart, which is the first gift card disclosures case brought by the Commission. In particular, the case challenges Kmart's failure to disclose the "dormancy" fee it applied to gift cards after two consecutive years of non-use and its misrepresentation that the gift cards never expired when (by virtue of the dormancy fees) some cards did expire. The proposed consent order ensures that, should Kmart charge fees or impose an expiration date in the future, Kmart must adequately disclose that information.

The proposed consent order also requires Kmart to provide refunds to all consumers with Kmart gift cards who had fees deducted from their cards and want refunds. Because Kmart stopped imposing fees in May 2006, the affected Kmart gift cards were purchased or received several years ago – at some point before May 2004 – and then were not used for two consecutive years. The order mandates a refund program for any consumers holding such cards who still want to use their Kmart gift cards.

In your comments, you suggest three modifications to the proposed order: that dormancy fees be restored to cards automatically, that a process be introduced for consumers who have discarded their cards to participate in the dormancy fee refund program, and that outreach about the refund program be more widespread. Each of these comments is addressed in turn.

First, the refund program provided in the order, although not automatic, is a simple one. Consumers can obtain a refund by calling a toll-free number, sending a letter to a designated address, or writing a brief email message. Moreover, the Commission does not believe that a significantly greater percentage of consumers would redeem their cards and receive refunds of dormancy fees under a reimbursement program that proceeded automatically, an analysis based in part on confidential information provided to the staff. Second, your proposal that consumers be permitted to seek refunds from Kmart solely by asserting they once had a gift card of a certain value presents a significant potential for fraud with no mechanism in this case by which to ensure only eligible consumers receive refunds. Finally, as for outreach, the Commission's announcement of the case has been published in many nationwide media outlets, including, for example, the Associated Press, *The Wall Street Journal*, *The Chicago Tribune*, *The Washington Post*, CNNMoney.com, DMNews, and nationally syndicated columnist Michelle Singletary's "The Color of Money" column. In addition, the Commission operates a consumer hotline to help inform consumers about the refund program. Also, the order requires Kmart to explain its refund program to *anyone* who inquires or complains to Kmart about a gift card balance, as well as to announce it on its Web site.

You also suggest that there can be no valid business justification for charging dormancy fees. Based on the Commission's understanding of this industry, the imposition of dormancy fees or expiration dates was driven by accounting practices. Specifically, fees and expiration dates are mechanisms to assist gift card retailers as they account for revenue from gift card sales.¹ Further complicating this accounting problem, and supporting the practice of imposing dormancy fees or expiration dates, are state escheat laws, which generally require holders of "abandoned" property to remit such property to the state. In some states, unredeemed gift cards are expressly considered abandoned property which must escheat to the state after the relevant time period for "abandonment" has passed. In light of the complexities of gift card accounting and escheat statutes, many companies chose to impose dormancy fees or expiration dates on their gift cards, thereby converting their gift card liabilities into revenues for accounting purposes prior to the applicability of state escheat laws. Recognizing these accounting issues, the Securities and Exchange Commission in 2005 provided the gift card industry with new accounting guidance about how and when to shift certain gift cards, for accounting purposes, from liabilities to revenues.² Because such business reasons for these practices exist, the Commission does not

¹ See "Retailers Face Complex Issues with Unused Gift Cards," *MarketWatch*, Dec. 29, 2006 (noting that under generally accepted accounting principles, gift card revenue at the time of the sale must be recorded as a liability until the gift card is redeemed).

² See Pamela Schlosser, Office of the Chief Accountant, U.S. Securities and Exchange Commission, Remarks before the 2005 AICPA National Conference on Current SEC and PCAOB Developments (Dec. 5, 2005), *available at*

Mr. David Balto, Esq.
August 14, 2007
Page 3

challenge the imposition of a dormancy fee or expiration date itself as a deceptive or unfair practice, as you advocate. Instead, the Commission here challenges the ways in which Kmart failed adequately to *disclose* these terms to consumers.

You further argue that disgorgement is particularly necessary to obtain deterrence. The Commission determined in this matter that disgorgement is not necessary to deter other marketers from the same conduct alleged in the draft complaint. First, Kmart has stopped charging dormancy fees. Further, over the last few years and before the Commission took any law enforcement action in this area, numerous retailers already changed their marketing practices.³ While many retailers eliminated expiration dates or fees altogether, the Commission staff has found generally that disclosures by retailers still imposing fees have improved. After considering all the factors that must be weighed in evaluating any settlement, including the specific facts, consumer injury, and the need to ensure that the remedies deter similar behavior by other retailers, the Commission has concluded that the strong injunctive provisions and mandatory refund provision achieve the desired deterrence, a positive result for consumers, and an appropriate resolution of this case.

After considering your comments, the Commission has determined that the public interest would best be served by issuing the Decision and Order in final form without modification. Respondents will be required to comply with the Order's injunctive and reimbursement provisions, and will be subject to potentially large civil penalties if they violate the Order.

Please remember that consumers may access the Commission's Consumer Hotline at **(202) 326-3569** for updated information about how to receive refunds if their Kmart gift cards were charged dormancy fees.

<http://www.sec.gov/news/speech/spch120505ps.htm>. This policy shift has helped encourage numerous retailers to stop imposing gift card dormancy fees and expiration dates; instead, retailers are calculating the amount of gift card value which will never be redeemed and claiming that amount as income over time.

³ See, e.g., "Gift Cards 2006: Retail Cards Continue to Improve (with Prodding); Bank Cards Still Have Problems," Montgomery County, Maryland, Division of Consumer Affairs, Nov. 28, 2006, *available at* <http://www.montgomerycountymd.gov/content/ocp/giftcardreportfinal2006.pdf> (finding none of forty surveyed retailers inadequately disclosed dormancy fees or expiration dates, and reflecting a trend of fewer retailers employing such restrictions in their gift card programs).

Mr. David Balto, Esq.
August 14, 2007
Page 4

Thank you again for your comments. The Commission is aided in its analysis by hearing from a variety of sources in its work, and it appreciates your interest in this matter.

By direction of the Commission, Commissioners Harbour and Leibowitz concurring in part and dissenting in part.

Donald S. Clark
Secretary