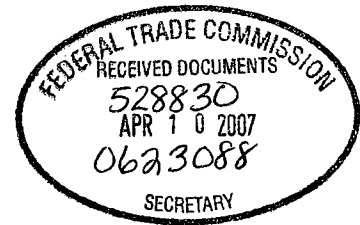


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April 10, 2007

Federal Trade Commission
Office of the Secretary
Room H-135 (Annex J)
600 Pennsylvania Avenue, N.W.
Washington, DC 20580



Re: Public Comment on Proposed Consent Decree in
Kmart Corp., FTC File No. 062 3088

Dear Secretary Clark:

As representatives of the public interest, the Consumer Federation of America, Consumers Union, and US PIRG, appreciate this opportunity to comment on the Federal Trade Commission's ("FTC's") proposed consent decree in Kmart Corp. As we explain herein we believe that the Commission has made a serious error in failing to secure adequate relief against Kmart. We believe that the remedy proposed by the FTC is inadequate and offers little opportunity to reimburse the consumers harmed by Kmart's practices. We address the deficiencies of the remedial provisions of the order and recommend three steps to strengthen the provisions to compensate harmed consumers. Moreover, we agree with the dissenting statements of Commissioners Leibowitz and Harbour that a remedy should include disgorgement of all of the ill-gotten revenue secured by Kmart through the deceptive practices described in the complaint. Without disgorgement Kmart will remain unjustly enriched by its deceptive and unfair conduct. And the lesson to other firms is that they can get away with unfair and deceptive conduct with just a slap on the wrist.

We begin with an observation of three information gaps that impact our ability to effectively evaluate the proposed remedy and determine whether it is adequate in alleviating the harm to public from these deceptive practices. First, the Commission has not responded to the concerns articulated in the dissenting statement of Commissioners Leibowitz and Harbour. Typically, in competition cases when there is a dissent the majority responds to the concerns raised by the dissent and provides their reasons for not supporting the views in the dissent. In this case, the majority has not responded to the concerns of the two Commissioners or articulated its basis for not seeking disgorgement. Thus, we simply do not know why the Commission thought disgorgement was unnecessary.

Second, the Commission has not indicated the number of consumers or the amount of financial harm of Kmart's deceptive practices. We have no indication of whether a handful or perhaps thousands of consumers were affected.¹ Obviously, the greater the number of consumers involved and the amount of deceptive fees secured significantly increases the need for more comprehensive relief. We assume because of the increasing popularity of gift cards and the significance of Kmart – one of the largest retailers in the United States – that this conduct harmed thousands of consumers.

Finally, we note that the Commission has not articulated the standards for monetary remedies such as disgorgement and restitution in consumer protection cases. This is unlike competition cases in which the Commission has articulated the standards for seeking monetary relief.² We do not understand why the Commission has not articulated its policy in for monetary relief in consumer protection cases, especially since the Commission secures monetary relief in far more consumer protection than competition cases. The lack of an articulated policy diminishes our ability to effectively comment on the Commission's decision not to seek disgorgement or restitution.³ Moreover, failing to articulate these policies may weaken the ability of the Commission in future cases to secure relief in litigation if the Commission's actions seem inconsistent with past actions.

We think there should be little question that the Commission's enforcement action in this case was necessary and appropriate. According to the facts alleged in the Commission's complaint, Kmart engaged in clearly deceptive conduct in marketing the Kmart gift card by secretly assessing a fee for nonuse known as a "dormancy fee." To understand the significance of the conduct from a consumer's perspective one must recognize that gift cards are a relatively new payment device. Consumers are used to using various plastic payment mechanisms such as credit, debit and ATM cards. The vast majority of credit, debit and ATM cards do not charge consumers fees per transaction, nor do these cards terminate after a period of time. Nor do these cards assess any type of dormancy fee. So it would have been reasonable for consumers to assume that their gift card would continue to retain its value for which the consumer had already paid even if not used within a period of time.⁴

¹ There is some indication in the recently filed matter involving Darden Restaurants that the potential harm exceeded \$30 million and the FTC initially sought monetary relief in that amount. Leo Jakobson, "Breaking News: No Fines in Gift Card Disclosure Case," Gift Card Newsletter (March 15, 2007). Since Kmart is a far larger retailer and the deceptive fees it imposed were 50% higher than those imposed by Darden Restaurants the amount of consumer harm may be far more substantial.

² Policy Statement on Monetary Equitable Remedies in Competition Cases, 68 Fed. Reg. 45,820 (Aug. 4, 2003) [hereinafter *Policy Statement*].

³ We suggest the Commission remedy this problem by publishing a statement on monetary relief in consumer protection cases.

⁴ The regulatory environment on gift cards is far less comprehensive than other plastic payment mechanisms. Certain consumer rights and remedies for credit and debit/ATM cards are specified through Truth in Lending Act and the Electronic Funds Transfer Act. However, there is significant uncertainty about the degree to which certain types of stored value cards, of which gift cards are a large subset, are subject to the EFTA, which is triggered by the presence of a consumer asset account. In addition, gift cards are not subject to any specific federal law that limits fees or details specific disclosures. While some states have addressed gift card fees, consumers do not have a uniform set of baseline protections.

Thus, consumers should have expected that gift cards like other plastic payment devices would be free of dormancy fees, would not expire, and would retain their value even if not used. As the Commission's complaint alleges, Kmart supported those perceptions by representing, expressly or by implication, that a consumer could redeem a Kmart Gift Card for goods or services of an equal value to the monetary amount placed on the card, while engaging in a scheme to charge secret dormancy fees that significantly diminished the value of the cards. According to the complaint, Kmart "failed to disclose, or failed to disclose adequately, that, after 24 consecutive months of non-use, a \$2.10 fee [was] deducted, for each of the past 24 months, and again for each successive month of continued inactivity, from the value of the Kmart Gift Card." The complaint also alleges that Kmart also represented on the Kmart website that Kmart Gift Cards "never expire." But by assessing the dormancy fee retroactively, the FTC observed that after 24 months of non-use any Kmart Gift Card valued at less than \$50.40 basically expired. Simply, consumers with a card over two years old lost all the value of the card through Kmart's use of secret dormancy fees. The Commission appropriately concluded that both the failure to disclose the dormancy fee and the representation that the Kmart Gift Card never expired was false and misleading.

The proposed consent order contains provisions to prevent future harm by requiring disclosure of material terms and conditions of any expiration date or fee before the card is purchased. We do not comment on the adequacy of these disclosure provisions to prevent future deceptive conduct.⁵ In terms of the past conduct, we believe that the proposed relief is clearly inadequate to remedy the harm to consumers.

First, to compensate the harmed consumers the proposed consent order requires Kmart to reimburse the dormancy fees for those consumers who provide an affected gift card's number, a mailing address, and a telephone number. Kmart will publicize the refund program on its website, including a toll-free number, e-mail address, and a postal address for eligible consumers to contact Kmart to seek a refund. We believe this approach to compensate harmed consumers is inadequate. It is wholly unrealistic to believe that this remedy will provide compensation for more than a small handful of consumers. Kmart has only a modest obligation to seek out and inform consumers who were victims of the secret dormancy fees. The order does not require Kmart automatically to restore dormancy fees absent a consumer request and that request requires the consumer to provide the affected gift card's number. Because gift cards are of limited value many consumers probably disposed of them after a period of nonuse. Those consumers who were informed by Kmart that their cards were worthless are extraordinarily unlikely to have retained their cards. Thus, the vast majority of harmed consumers are unlikely to receive any compensation.

We recommend three steps to strengthen the direct remedial provisions to compensate harmed consumers. First, all value from dormancy fees should be restored to all cards, automatically and without request by the cardholders. The Commission required complete restoration of fees in the recent Darden Restaurants matter and we see no reason why Kmart

⁵ We believe that the use of any dormancy fee may be an unfair practice that may violate Section 5 of the FTC Act. Again, we note that other payment mechanisms do not assess a dormancy fee.

should not face an identical obligation.⁶ Second, consumers who discarded the cards after being informed that they had lost their value should be offered a process to request reissue at no charge of the lost value, or at the consumer's option, a cash refund of the fees. Third, Kmart should be required to engage in a widespread outreach campaign to educate consumers to use cards formerly shown as unusable due to dormancy fees.

Even with these stronger direct remedial provisions, we believe that Kmart will likely secure substantial revenue from its unlawful conduct. That is why we agree with Commissioners Leibowitz and Harbour that disgorgement is necessary to ensure that Kmart does not benefit from its deceptive conduct. A remedy must not simply attempt to reimburse consumers for the harm they have suffered; it must also prevent the wrongdoer from profiting from its conduct in any fashion. Only then will the remedy counteract the incentive of the wrongdoer to engage in future illegal conduct and set a precedent for future wrongdoers that there will be significant penalties for violating the law. The Commission's proposed decree fails to meet this second goal of establishing a significant deterrent to future illegal conduct. That is why the Commission should require disgorgement of all of Kmart's ill-gotten gains.

As we mentioned there is no statement articulating the policy on seeking monetary relief such as disgorgement in consumer protection cases. We think the policy for monetary relief in competition cases offers valuable guidance. In competition cases, the Commission has set forward a policy that "as a general matter," it would consider the following three factors in determining whether to seek monetary remedies: (1) whether the underlying violation was clear; (2) whether there is a reasonable basis for calculating the amount of a remedial payment, and (3) whether Commission action would add value in light of any other remedies available in the matter, including private actions or criminal proceedings. We think it is clear this matter would meet each of these standards. The conduct at issue was straightforward deception. The Commission has the information necessary to reasonably calculate the amount of disgorgement.⁷ Finally, other remedies are unlikely to be effective in this situation. Since the amount of any individual claim is very small and individual consumers probably lack documentation of their cards, private litigation is unlikely to either occur or be particularly effective.

Finally, we think disgorgement particularly is necessary and appropriate in this case because this conduct was egregious and deceptive. As we noted earlier no other payment mechanism that we are aware of assesses a dormancy fee. There is no reason why consumers should have expected that a dormancy fee would have been assessed. Moreover, we see no business justification for charging consumers dormancy fees especially of such a significant amount. Certainly there may be some costs of keeping cards active, but these costs are trivial compared to the dormancy fees assessed, and are offset by the float earned by Kmart while holding funds provided to purchase the cards and by the business value gift cards serve in bringing in new customers or encouraging existing customers to make larger purchases. Further,

⁶ Darden Restaurants, Inc. FTC File no. 062 3112 (April 3, 2007). Actually, since Kmart's conduct was more egregious than Darden's – Kmart actively falsely represented that their gift cards never expired – they should face an even tougher remedy than Darden.

⁷ Such information should be relatively easy to access. In fact, the Kmart order requires Kmart to disclose information on the amount of dormancy fees collected in the future.

gift cards are a significant source of revenue since they often are not redeemed for their full value.

We commend the Commission for this enforcement action. Gift cards have increased dramatically as an important payment mechanism used by millions of consumers. Most gift cards are issued by nonbanks which are less regulated than financial institutions. That is why the FTC's failure to seek adequate relief is even more troubling: it sends a signal to nonbanks that they do not have to exercise the level of care imposed on most payment devices. In the future nonbanks will consider new ways of securing payments revenue or develop new payments devices. As these products develop, the lack of regulation and the relief in Kmart provides little disincentive for these firms to engage in deceptive and fraudulent conduct. This remedy allows Kmart to collect a windfall from its deceptive conduct. That will weaken the Commission's enforcement efforts in future cases. Consumers suffer unless the penalty fits the wrongdoing.

Thank you for considering our comments. If you have any questions, please contact me.

Sincerely,

David A. Balto

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