

FEATURE ARTICLES

Deceptive Claims for Prepaid Telephone Cards and the Need for Regulation

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I. Introduction

The United States prepaid phone card industry is a multi-billion dollar industry. In 2002, prepaid long distance cards alone generated \$3.6 billion and the industry is estimated to grow significantly.¹ Growth in the market for prepaid phone cards is expected to continue, in part because sales are linked to the increasing use of cellular phones.² Already the bulk of convenience stores' general merchandise sales are for prepaid phone cards.³ In fact, one industry

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¹ Mitch Morrison, *Paying Dividends: The Prepaid Category Continues to Grow and it's Not Just Phone Cards Anymore*, 39 CONVENIENCE STORE NEWS 48 (2003).

² Brian Cook, Thomas K. Crowe & Jo Ann Scott Cullen, *Experts Predict-Prepaid Forecast 2002*, INTELE-CARD NEWS, Jan. 2001, http://www.intelecard.com/story_home.asp?StoryID=342 (last visited Sept. 11, 2006); Richard Gutwillig, *Calling on Savvy*, 55 SUPERMARKET BUS. MAG. 89 (2000).

³ Michael Browne, *Generally Speaking: Selling a Variety of General Mer-*

source reports that phone cards are the highest profit center in Walgreens stores after prescriptions.⁴

The cards are often promoted to niche markets consisting of college students, immigrants and certain businesses.⁵ According to Barry Catmar, vice president of operations for Digitac, “the large number of immigrants who call friends and relatives abroad is a perfect market for phone cards.”⁶ The increase in the immigrant population in the United States, especially Latino consumers, has led to the marketing of some cards specifically to the Spanish-speaking consumer.⁷ As a result, the market for prepaid telephone cards is segmented and some groups of consumers are particularly vulnerable.⁸ There is evidence that consumers in the United States who use cards to call Spanish-speaking countries face much higher prices than expected due to hidden fees and confusing, contradictory and inaccurate information.⁹

In most states, there is little or no regulation of prepaid telephone cards. Thus most states do not require phone card companies to disclose essential information and substantive rights that ensure consumers receive satisfactory service. Consequently, information provided on the cards and by customer service representatives is often misleading or unavailable.¹⁰

chandise Draws Customers, High Margins, 40 CONVENIENCE STORE NEWS 37, 37 (2004).

⁴ Howard Segermark, *Why Market Phone Cards?* 30 NAT’L PETROLEUM NEWS 30, 30 (June 2002).

⁵ Cook, Crowe & Cullen, *supra* note 2, at 14; Gutwillig, *supra* note 2 (reporting that card sellers are targeting home-based businesses and traveling salespersons). Military personnel also are major users of prepaid calling cards. *FCC Taps Calling Cards for Access, USF Payments*, TELECOM POL’Y REP., July 10, 2006.

⁶ Gutwillig, *supra* note 2. Digitac sells computers and computer services. *Id.* <http://www.digitac.com.aa> (last visited Sept. 27, 2006).

⁷ Mary Louise Pickel, *Phoning Mexico...for profit*, ATL. J.-CONST., June 8, 2006; Cook, Crowe & Cullen, *supra* note 2; Gutwillig, *supra* note 2.

⁸ Alan R. Andreasen, *Disadvantaged Hispanic Consumers: A Research Perspective and Agenda*, 16 J. OF CONSUMER AFF. 46,48 (1982); Jinkook Lee & Horacia Soberon-Ferrer, *Consumer Vulnerability to Fraud: Influencing Factors*, 31 J. OF CONSUMER AFF. 70, 72 (1997).

⁹ Julia Marlowe, *Investigation of Pre-Purchase Information on Prepaid Telephone Cards*, Report to the Georgia Governor’s Office of Consumer Affairs 1 (Sept. 2005); Julia Marlowe & Martina Rojo, *Consumer Problems With Prepaid Telephone Cards*, 51 CONSUMER INTS. ANN. 126, 128-30 (2005).

¹⁰ The Mexico Tri Color card, purchased in 2005, provides an example of misleading information. The card reads “sin cargo de conexión” on the front in large

Consumers have few rights, and even where consumers do have rights that are violated, it is often difficult for them to obtain a remedy. Additionally, because each card has a small monetary value, litigation is not always a viable option, especially if contracts include arbitration clauses and prohibit class actions.¹¹ For example, low-income consumers are likely to purchase cards that sell for less than \$10, rendering the apparent cost of using prepaid phone cards insignificant. Because of their low income, however, the cumulative cost may be significant.¹² Furthermore, many immigrants have no alternative if they need the cards in order to communicate by phone with their families in another country.

Given these conditions, the federal and the state governments should consider passing legislation to regulate phone cards. On the federal level, both the Federal Trade Commission (FTC) and the Federal Communications Commission (FCC) have done little to address the problems other than minimal enforcement of current inadequate regulations. The FTC has addressed few instances of deceptive advertising,¹³ and the FCC currently enforces the limited area of federally required fees on prepaid phone cards.¹⁴ On the state level, consumer protection varies greatly. Legislation is warranted unless (1) the market works and consumers acting reasonably are able to make efficient choices and protect themselves, (2) the loss to consumers is small and there are few reported consumer problems and (3) market conditions are such that the industry can be counted upon to engage

print, but the small print on the back reads “cargos de conexión aplicaran.” The statement on the front informs the consumer there are no connection charges, but the statement on the back says the opposite. Marlowe & Rojo, *supra* note 9, at 127. Customer service representatives sometimes provide confusing information. For example, one told a consumer the phone card had a “maintenance fee of \$0.50 every one or two days.” *Id.*

¹¹ AT&T v. Ting, 182 F. Supp.2d 902, 930 (N.D. Cal. 2002), *aff'd* 319 F.3d 1126 (9th. Cir. 2003), *cert. denied*, 124 S. Ct. 53 (2003); see Jean Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?* 42 WM. & MARY L. REV. 1 (2000).

¹² According to the U.S. Census Bureau, 37 million people in the United States live in poverty. Bradley R. Schiller, *Fluid Poverty*, ALBANY TIMES UNION, Sept. 24, 2006 (noting that more than 20% of Hispanics in the United States live in poverty).

¹³ See, e.g., Press Release, FTC, Marketer of Pre-Paid Cards Agrees to Settle Charges of Failing to Disclose Actual Cost of Using Card; Additional Charges Per Call Added, Some Cards Incurred Monthly Maintenance Fee (Mar. 4, 1999).

¹⁴ *Phone Card Issuers Must Pay Access Fees*, N.Y. TIMES, July 4, 2006, at C9 (reporting that the FCC ruled AT&T must make Universal Service Fund payments on its prepaid calling card transactions).

in effective self-regulation.

This article explores the need for legislation by reviewing a combination of approaches, including an economic analysis of the market for prepaid phone cards, findings from an empirical study of Hispanic phone card usage in calling Spanish-speaking countries, and the current law on this issue. The results of this investigation demonstrate a need for national regulation. We recommend that Congress enact a statute which mandates a minimum standard of protection and authorizes the FTC to issue regulations. Such a federal statute would also contain disclosures, substantive protections, and consumer remedies. Additionally, states should be permitted to enact requirements that provide more protection as long as they are not inconsistent with the federal law. If Congress decides not to pass a federal statute, state legislatures can easily adopt the features of our Model Prepaid Telephone Card Act.

II. Is Regulation Necessary? The Lessons from Economic Theory

Regulation is not necessary if consumers act reasonably and make efficient choices in the marketplace. Consumers can only make efficient choices if they are able to obtain the complete and accurate information needed prior to purchase without incurring excessive transaction costs. Such information may be contained in advertisements, in brochures accompanying the sale of the cards, on the packaging, or on the cards themselves. Another source of information is experience. Experience may come from the consumer's prior use of cards or from others, such as family and friends, who have used the cards. For the consumer to obtain enough information through experience, significant information search costs may arise, thereby raising the price of the product much like transaction costs. A consumer would incur significant search costs if he repeatedly paid for transportation to a store and spent money on a card that did not provide many minutes (though the advertising might state otherwise). Each time he must try a different card brand in order to find one that is cost-effective. However, he may be forced to try several cards before discovering a good card. Even then significant search costs continue if rates on the good card have changed.¹⁵

Theoretically, prepaid telephone cards come close to fitting the perfect competition model. Prepaid telephone cards are a ho-

¹⁵ See Phillip Nelson, *Information and Consumer Behavior*, 78 J. OF POL. ECON. 311, 312 (1970).

mogenous product (consumers buy minutes), and there are many buyers and sellers due to the ease of entry into and exit from the market.¹⁶ However, in the perfect competition model, consumers have perfect information. Perfect information is rarely present, but consumers can typically search for information and make informed purchase decisions for many products.

The prepaid telephone card market is one where information could be made available to allow consumers to make better informed purchase decisions. Yet, investigations of the market indicate that either consumers cannot obtain information, or the information is inaccurate, contradictory or deceptive.¹⁷ Moreover, information is often not available from customer service, and consumers also may be misled by seller misconduct such as card issuers who sell defective cards.¹⁸ Consumers retain information from past purchase experience, but information from previous experience is likely to become outdated over time as terms and conditions of the cards change.

III. Problems Encountered by Consumers and Information Needed: Findings from an Empirical Study

Even if information is not available prior to purchase and customer service is inadequate, regulation may be unnecessary if prepaid telephone cards are inexpensive. In that situation consumers are able to learn what they need to know in order to avoid problems without incurring high costs. However, while each card is inexpensive, the unit price, or cost per minute, may be significant and consumers who rely on prepaid phone cards for many of their calls end up paying an excessive amount for telephone service. The prepaid phone card market has grown into a multi-billion dollar industry, and the cost to consumers as a group is tremendous, especially for certain segments of the population.

A qualitative study of forty-five Latino immigrants' experiences in an urban market in Georgia found that 78.7 percent of the immigrants complained about prepaid telephone cards.¹⁹ More spe-

¹⁶ Segermark, *supra* note 4, at 30.

¹⁷ Marlowe, *supra* note 9, at 4-5; Marlowe & Rojo, *supra* note 9, at 128.

¹⁸ Nancy Luna, *Phone Card or PhonyCard?* ORANGE COUNTY REG., Aug. 20, 2005 (reporting experience of consumer who was never able to use her defective card to make a call).

¹⁹ Julia Marlowe & Jorge H. Atilas, *Consumer Fraud and Latino Immigrant*

cifically, consumers complained that they did not receive the number of minutes they expected and that customer service personnel could not be reached during available hours and often could not answer consumers' questions even when reached.²⁰ A follow-up study was conducted to verify these complaints.²¹ The follow-up study investigated the true costs of the cards and the information available from customer service.²² Minutes are often deducted for hidden fees, and consequently, consumers do not receive the number of minutes they are told are available. True cost is calculated by determining cost per minute using an accurate amount of minutes received.²³ In the study, over 250 prepaid telephone cards costing under eleven dollars were purchased and then used by bilingual data collectors to call Spanish-speaking countries from January until May 2004.²⁴

Before placing the calls, each data collector called the customer service number and asked a series of questions from a survey designed by the researchers.²⁵ Customer service personnel were asked about (1) the number of minutes the customer would have to call a specific city, (2) various kinds of fees that might be charged, (3) minute rounding, and (4) hours of customer service availability.²⁶ Data collectors then placed a call, using only one-half of the number of minutes that the recorded message indicated was on each card.²⁷ This was done to ascertain if maintenance fees, hidden charges, or both were present.²⁸ After at least one week, a second call was placed to the same city.²⁹ The date and time were noted at the beginning and end of each call.³⁰ The number of minutes available was also noted.³¹ Each card was used until all minutes had expired.³²

Consumers in the United States, 29 INT'L J. OF CONSUMER STUD. 391, 395-96 (2005).

²⁰ *Id.* at 395-96.

²¹ Marlowe & Rojo, *supra* note 9, at 130-31.

²² *Id.* at 132-33.

²³ *Id.* at 133.

²⁴ *Id.* at 130.

²⁵ *Id.*

²⁶ Marlowe & Rojo, *supra* note 9, at 130.

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ Marlowe & Rojo, *supra* note 9, at 130.

Calls were made to cities in Mexico, Colombia, Argentina, Peru, Spain, Uruguay, Guatemala, and Nicaragua.³³

The researchers computed expected cost by dividing the cost of the card by the initial number of minutes the consumer was told he or she had.³⁴ The actual cost of the card was computed by dividing the cost of the card by the actual number of minutes that a consumer obtained when using the card.³⁵ Cost was therefore computed as a unit price: cost per minute.³⁶ Findings from this research indicate that there is wide price dispersion with prepaid telephone cards.³⁷ The average actual cost of the cards was 87% higher than the average expected cost.³⁸

Data collectors also made three attempts to reach a customer service representative.³⁹ For two-thirds of the cards, it was possible to talk to a customer service representative.⁴⁰ The customer service representative answered on the first attempt for about one-half of the cards. For one-third of the cards, the consumers were not able to talk to a customer service representative, either because they were on hold for more than five minutes, no one answered, or there was only a recording.⁴¹ Furthermore, talking with a customer service representative was often not helpful.⁴² Although some customer service representatives were helpful, many times the customer service representative was not able to answer questions such as whether minute usage was rounded up or what fees were charged.⁴³

Subsequently, the researchers conducted an additional investigation of the information available on the cards.⁴⁴ One problem was that for some cards there was very little if any information about

³² *Id.*

³³ *Id.* at 132.

³⁴ *Id.* at 133.

³⁵ *Id.*

³⁶ Marlowe & Rojo, *supra* note 9, at 133.

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.* at 130.

⁴⁰ *Id.*

⁴¹ Marlowe & Rojo, *supra* note 9, at 130.

⁴² *Id.* at 131.

⁴³ *Id.*

⁴⁴ Marlowe, *supra* note 9, at 18-19.

fees.⁴⁵ Another problem was that no standardized wording existed.⁴⁶ For example, in some instances a “service” fee appeared to be assessed per call much like a connection fee and in other instances what was called a “service” fee was assessed periodically in the same manner as a maintenance fee.⁴⁷ Additionally, the wording of some information was vague, such as the use of the terms “as may apply.”⁴⁸ Stating that a maintenance fee “may apply” provides a warning for the consumer but does not tell the consumer if there is a maintenance fee or not.⁴⁹ Some maintenance periods are assessed after two days and others after 30 or 60 days.⁵⁰ A more serious offense was the use of contradictory or misleading wording.⁵¹ Many cards state that there is no connection fee but the fine print states that “connection fees may apply.”⁵² Some brands of cards have no connection fee but they have a fee at the end of each call, called a “post-call” or “hang-up” fee.⁵³ Other information is also unclear and perhaps deceptive, such as information about taxes, pay phone surcharges and warranties.⁵⁴

More accurate information should be given on the number of minutes available when one places a call. When a consumer places a call, he or she is told how many minutes are available. However, a consumer typically does not receive all of those minutes.⁵⁵ Minutes are deducted for a variety of reasons such as connection costs and minute rounding penalties.⁵⁶ Determining the true cost per minute is unnecessarily complex because the consumer does not know how many minutes are deducted, and for which fees they are deducted.⁵⁷ The costs include activation fees, connection fees, minute rounding,

⁴⁵ *Id.* at 4.

⁴⁶ *Id.*

⁴⁷ *Id.* at 4-5.

⁴⁸ *Id.* at 4.

⁴⁹ Julia Marlowe & Francisco Diaz, *Verification of Advertised Claims for Pre-paid Phone Cards* (Working Paper, 2006).

⁵⁰ Marlowe, *supra* note 9, at 4.

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.* at 5.

⁵⁵ Marlowe & Rojo, *supra* note 9, at 132.

⁵⁶ *Id.*

⁵⁷ Marlowe, *supra* note 9, at 4

extra pay phone fees, additional cell phone fees, charges even if no connection is made, maintenance fees, and service fees.⁵⁸ It would be helpful if companies provided information on which fees were applicable, even if the consumer would not know precise amounts.

Because of the great variation in the kinds of fees assessed, the difficulty in determining how the fees are assessed, and the lack of standardized wording, meaningful comparison shopping is impossible. Uniformity of information, disclosure and standardized names for fees would help consumers, much in the same way that nutritional labeling has provided a mechanism for uniform comparison. In some cases, outright consumer fraud may be present. Customer service representatives indicated that for some prepaid phone cards there were charges even if there was no connection. This is illegal in some states.⁵⁹ However, it was not possible to know if the consumer was charged for a call that was not connected.

IV. The Likelihood of Self-Regulation: The Nature of the Prepaid Phone Card Market

The third question addressed is whether the prepaid phone card industry can be expected to regulate itself. Self-regulation is probable when there are industry-wide standards available, the industry standards adequately protect consumers, and the industry is dominated by strong stable companies that are committed to those standards and can pressure other companies to comply.

Self-regulation is likely to occur if there are strict industry-wide standards. The industry's trade association, the International Prepaid Communication Association (IPCA) has adopted standards for its members.⁶⁰ One such standard requires that minute rounding be in one minute intervals.⁶¹ The problem is that there is no enforcement of the industry guidelines and no reason to believe that they are being followed by the majority of prepaid telephone card

⁵⁸ *Id.* at 4-5.

⁵⁹ CAL. BUS. & PROF. CODE § 17538.9(12) (West 2006) (a customer is not considered connected if the customer receives a busy signal or the call is unanswered); AL. PUB. SERV. COMM'N Rule T-18.1(7) (1997) (usage rates can be charged only for connected minutes); 16 TEX. ADMIN. CODE § 26.34(e)(2) (2000) (account may be decreased only for completed calls; busy signals and unanswered calls are not considered completed).

⁶⁰ ITA Phonocard Disclosure Guidelines, The Int'l Telecard Ass'n Standards Comm., June 5, 2000.

⁶¹ *Id.*

providers. According to Howard Segermark, Executive Director of the IPCA, only about 80 providers of the estimated 500 plus providers are members of the IPCA.⁶²

The IPCA standards are too limited to provide consumers with the protection that they need.⁶³ Even if the standards were satisfactory they could not serve as an adequate substitute for legal protections. For example, it is doubtful that the IPCA could pressure non-members of the association into complying with the standards unless the industry was dominated by stable companies who supported the IPCA standards. The prepaid phone card industry involves many different types of businesses such as: carriers, resellers, distributors, card issuers, and retailers. Absent rules having the force of law, compliance with voluntary standards is highly doubtful. Even if current businesses agreed to comply, someone would have to assume the responsibility to persuade the constant stream of new entrants who are enticed to enter the industry because of low start-up costs, and the general lack of compulsory registration or bonding, to comply with the standards. Additionally, even if the standards were satisfactory, there is no guarantee that they would not be changed without any prior notice to or input from consumer representatives. At the very least, contracts between issuers and consumers should incorporate the IPCA standards so consumers can sue in court for breach of contract if the issuers do not follow the standards.

Whether the industry can regulate itself hinges upon three factors: whether standards are available, whether they protect consumers, and whether the industry is dominated by strong stable companies. Although there are industry standards, they do not provide adequate protection for consumers because, as the empirical study indicates, the standards are not followed.⁶⁴ For example, information on minute rounding was available for less than half of the cards.⁶⁵ Of those for which information was available, slightly over half of the

⁶² Howard Segermark, Executive Director, International Prepaid Communications Association, personal interview with Julia Marlowe and Martina Rojo, at the offices of the Association, 904 Massachusetts Avenue, Washington, D.C., March 29, 2004. The International Prepaid Communications Association is the successor organization to the International Telecard Association.

⁶³ Compare ITA Phonecard Disclosure Guidelines, *supra* note 60, with the Model Act discussed *infra* in Part XI. For example, the IPCA standards do not include any rules on advertising. They do not require a minimum period before the card expires or redemption of unused value. Card issuers are not required to replace defective cards.

⁶⁴ Marlowe & Rojo, *supra* note 9, at 131.

⁶⁵ *Id.*

cards used more than one minute rounding.⁶⁶ Furthermore, the industry is not dominated by strong stable companies.⁶⁷ The fact that one can enter the market without incurring great costs means there are many providers. There is also evidence that the companies more likely to be considered stable, such as AT&T, MCI and Sprint actually cost more per minute than the other companies, and they do not give the consumer any better information than the lesser-known providers.⁶⁸ Our conclusion is that the industry cannot be expected to regulate itself.

Because of the problems consumers face in the marketplace and the dim prospects for adequate self-regulation, consumers need legal protection. The laws now on the books, however, fail to ensure that consumers receive the information, safeguards and remedies they require.

V. Adequacy of the Current Law

A review of current law demonstrates it is not adequate. No federal law governs prepaid phone cards except the Federal Trade Commission Act (FTC Act).⁶⁹ It applies generally to all industries subject to FTC jurisdiction.⁷⁰ The FTC Act simply prohibits deceptive and unfair acts or practices.⁷¹ It does not require any disclosures and is not tailored to the needs of consumers who purchase prepaid phone cards.⁷² Rather, the Act only protects consumers from the most egregious conduct.⁷³ Because there is no private right of action, it protects only the customers of those companies against whom the FTC brings an action.

Most states have no statutes or regulations covering prepaid phone cards. Among the states that do regulate the cards, there is a great deal of variation in coverage and regulation ranges from minimal to comprehensive. However, no state adequately protects con-

⁶⁶ *Id.*

⁶⁷ Gutwillig, *supra* note 2.

⁶⁸ Marlowe, *supra* note 9, at 3.

⁶⁹ 15 U.S.C. § 45(a)(1) (2006).

⁷⁰ *Id.* § 45(a).

⁷¹ *Id.* § 45(a)(1).

⁷² *Id.*

⁷³ The FTC Act merely declares unfair and deceptive acts to be unlawful. 15 U.S.C. § 45(a)(1) (2006). It does not establish any requirements for disclosure of essential information, levels of performance, customer service or error resolution.

sumers.⁷⁴ Most states have laws prohibiting unfair and deceptive acts and practices in general.⁷⁵ While the laws provide for a private right of action,⁷⁶ many do not allow class actions,⁷⁷ which are crucial for cases involving purchases of inexpensive items. Also, the state laws suffer from the same deficiencies as the FTC Act.

Consumers may be able to attack the agreement between the seller and the consumer through general contract law avenues. For example, if the card does not work, or if there is no access number or authorization code, the consumer can claim failure of consideration. If the contract is too one-sided, a court may find it is unconscionable, but the doctrine of unconscionability has limited usefulness.⁷⁸ Contract law is totally inadequate to protect consumers because it only provides a remedy for rights that the contract grants to consumers.⁷⁹ Such contracts, one-sided agreements presented by the card seller on a take-it-or-leave-it basis, impose few obligations on card sellers.⁸⁰

⁷⁴ See *infra* Part X discussing problems not dealt with in any laws.

⁷⁵ MICHAEL M. GREENFIELD, CONSUMER LAW: A GUIDE FOR THOSE WHO REPRESENT SELLERS, LENDERS, AND CONSUMERS 160, 559 (Little, Brown 1995).

⁷⁶ Courts in some states have made it very difficult for consumers to bring actions under these laws. See, e.g., *Zeeman v. Black*, 273 S.E.2d 910, 915 (Ga. Ct. App. 1980) (imposing a “public interest” requirement that is not included in the statute).

⁷⁷ E.g., GA. CODE ANN. § 10-1-399(a) (2006).

⁷⁸ Most courts require consumers to prove both procedural and substantive unconscionability. Greenfield, *supra* note 75, at 529-34. To prove procedural unconscionability the consumer must show the process under which the consumer entered into the contract was unconscionable. To prove substantive unconscionability, the consumer must prove the terms in the contract were unconscionable. Some courts allow the doctrine to be raised only as a defense, which means consumers can challenge a contract as unconscionable only if the seller has sued them. They cannot use it affirmatively as the basis of their own lawsuit against the seller. *Rosboro Lumber Co. v. Employee Benefits Ins. Co.*, 672 P.2d 1336, 1338 (Or. Ct. App. 1983), *rev'd on other grounds*, 680 P.2d 386 (Or. 1984).

⁷⁹ See generally Official Comment U.C.C. § 1-203 (2005). The Comment provides that “failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract.... [T]he doctrine of good faith merely directs a court toward interpreting contracts within the commercial context in which they are created, performed and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached.”

⁸⁰ See generally *Discover Bank v. Superior Court*, 30 Cal. Rptr. 3d 76, 113 P.3d 1100, 1109-10 (Cal. 2005) (stating that adhesion contracts are unconscionable, “at least to the extent they operate to insulate a party from liability that otherwise would be imposed under [state] law”).

VI. Should Phone Cards Be Regulated at the State or Federal Level?

Strong arguments can be made to support both the position that regulation of phone cards should be through federal law and the contrary position that it should be through state law. We recommend a combination of both state and federal legislation. A consideration of the merits of legislation if it were administered either by the states or by Congress illustrates the issues that inform our proposal.

Despite the fact that most states are not eager to tackle this problem,⁸¹ several factors indicate that state regulation might be superior to federal regulation. State regulation can be tailored to the needs of that state's residents. For example, a state with a large immigrant population may want to enact more protective rules than others. This would be justified because many card sellers specifically target low-income, non-English speaking groups that may be especially vulnerable to unfair practices.⁸² Such a state may want to enact bilingual disclosure requirements, with special attention given to international calls. That state may also feel a need for strong substantive protections, such as rules guaranteeing a right to redeem unused value and setting a minimum time to use a card before it expires. Because of the tenuous or non-existent legal status of many consumers targeted by those who market phone cards, they often refuse to sue companies that engage in illegal practices or to complain to government agencies.⁸³ Special rules tailored to meet the needs of particular

⁸¹ This is in contrast to gift cards. Far more states have enacted laws regulating that type of stored value card. MARK BUDNITZ & MARGOT SAUNDERS, CONSUMER BANKING & PAYMENTS LAW CREDIT, DEBIT & STORED VALUE CARDS, CHECKS, MONEY ORDERS, E-SIGN, ELECTRONIC BANKING AND BENEFIT PAYMENTS 178-79 (National Consumer Law Center 3rd ed. 2005).

⁸² Prepaid phone cards have been identified as a key problem area for Hispanics. Federal Trade Commission, Hispanic Outreach Forum & Law Enforcement Workshop: A Summary of the Proceedings, at 8 (Oct. 2004), <http://www.ftc.gov/reports/hispanicoutreach/hispanicoutreach.pdf>. (last visited Sept. 11, 2006). Fraudulent practices involving the cards are "likely to be targeted to immigrant populations." *Id.* at 9. "Hispanics are noted for their trusting nature, which means they maybe easier prey for scam artists." *Id.* at 8. *See generally* Hoover's In-Depth Company Records, Ace Cash Express, Inc. Aug. 24, 2005 (reporting that Ace Cash Express, Inc. targets consumers who do not have bank accounts, selling them prepaid phone cards, and controversial products such as payday loans).

⁸³ Hispanic Outreach Forum & Law Enforcement Workshop: A Summary of the Proceedings, *supra* note 82, at 10. "...the concept of the government protecting consumers may be foreign to many Hispanics." *Id.*

immigrant populations would have a better chance of being included in state law than in federal legislation since lawmakers from states without large immigrant groups may not recognize or understand the importance of protecting them.

In addition, states have administrative agencies with expertise in drafting regulations and enforcing rules related to telecommunications.⁸⁴ Some states give the agencies crucial regulatory roles apart from issuing regulations. For example, in Illinois and Florida, providers of prepaid card services and resellers must receive a certificate of authority from a state agency.⁸⁵ Retailers selling the cards must have proof that the provider or reseller has obtained the certificate.⁸⁶ It is unlawful for companies to fail to comply with these requirements.⁸⁷

On the other hand, federal legislation has several advantages over state regulation. The most obvious benefit is complete national coverage.⁸⁸ Another benefit is uniformity.⁸⁹ Complete and uniform national coverage helps both the industry and consumers. Many phone card companies sell cards in many states. Having one set of rules greatly lessens their regulatory burden. Furthermore, many companies sell cards on the Internet. A uniform set of rules greatly eases their regulatory burden since they are selling to consumers nationwide. The phone card industry may mount less opposition to a federal law than to state laws because of the advantages of having to comply with only one law. They may actually support a federal law in the belief it would discourage the majority of states that have not

⁸⁴ Administrative agencies in the following states have regulations pertaining to prepaid phone cards. AL. PUB. SERV. COMM'N Rule T-18.1 (2000); FLA. ADMIN. CODE ANN. r. 25-24.900-935 (2006); MO. CODE REGS. ANN. tit. 4, § 240-32.160-70 (2006); 16 TEX. ADMIN. CODE § 26.34(e)(4) (2000) .

⁸⁵ 815 ILL. COMP. STAT. 505/2QQ (2006); FLA. ADMIN. CODE ANN. r. 25-24.910 (2006). Some states require providers of the service to file tariffs. FLA. ADMIN. CODE ANN. r. 25-24.915 (2006); 16 TEX. ADMIN. CODE § 26.34(e)(1) (2000).

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ "...federal law applies nationally." Salt Lake Tribune Publ'g Co. v. Mgmt. Planning, Inc., 390 F.3d 684, 688 (10th Cir. 2004).

⁸⁹ "Because federal law applies nationally," courts should assume "that Congress desires national uniformity in the application of its laws." *Id.* See Laura S. Langley, *Sperm, Egg, and a Petri Dish*, 27 J. LEG. MED. 167, 206 (2006) (proposing federal legislation because it would create uniformity among the states).

yet regulated phone cards from enacting their own laws.⁹⁰

In addition, uniform disclosures, standardized terms, and the same rights help produce educated consumers. This is especially important given the high mobility rates of people who live in the United States.⁹¹ Most will live in several states during their lifetimes. With a federal law, they do not have to learn a new set of rules and definitions every time they move to a new state.

A federal rule may also lead to more effective enforcement than state law. An individual state may have great difficulty enforcing its laws against companies operating from different states, especially those selling on the Internet. Jurisdictional issues may frustrate enforcement.⁹² Enforcement by a federal agency would obviate many of these difficulties.

Lacking a Congressional mandate, no agency of the federal government has stepped forward to regulate this industry. Prepaid phone cards are payment devices.⁹³ The Federal Reserve Board (FRB) has substantial experience regulating payment devices, but lacks experience regulating the telecommunications industry.⁹⁴ Drafting regulations and enforcing them is better suited for an agency familiar with that industry. Prepaid phone cards provide access to telephone service. The agency with the most expertise in telecommunications, the FCC, has no experience dealing with payment devices. The FCC simply refers consumer complaints to the FTC, the Better Business Bureau, and state agencies.⁹⁵ Moreover, any federal

⁹⁰ See, for example, the industry's response to state laws requiring companies to notify consumers when there is a security breach resulting in the possible exposure of personal information about consumers. Katie Kuehner-Hebert, *Data Privacy Now Issue for States*, 170 AM. BANKER 1, Mar. 28, 2005 (noting how businesses prefer a federal statute over a patchwork of state laws).

⁹¹ Fourteen percent of the people in the United States, totaling 40 million people, move or change their address every year. Stephanie Fiereck, *Focus on Class Action*, NEW JERSEY LAW., Oct. 31, 2005 (relying on data from the U.S. Census Bureau's Geographical Mobility Study 2002-2003).

⁹² *E.g.*, Neogen Corp. v. Neo Gen Screening, Inc., 282 F.3d 883, 887 (6th Cir. 2002); Gator.com Corp. v. L.L. Bean, Inc., 341 F.3d 1072, 1075 (9th Cir. 2003).

⁹³ Prepaid phone cards are analogous to payment devices such as credit cards, that are defined as devices for "the purpose of obtaining...property...or services." 15 U.S.C. § 1602(k) (2006).

⁹⁴ The Federal Communications Commission has authority to regulate interstate telephone service. 47 U.S.C. § 201 (2006). See *AT&T Corp. v. Iowa Util. Bd.*, 525 U.S. 366, 384 (1999) (clarifying the FCC's rulemaking authority under the Telecommunications Act).

⁹⁵ FCC, Prepaid Phone Cards: What Consumers Should Know,

agency to which Congress delegates the responsibility for regulation would not be as attuned to local problems as are state agencies.

Although the FTC does not have a great deal of technical expertise in telecommunications, its Telemarketing Sales Rule indicates it is able to draft effective regulations related to telephone use.⁹⁶ It has brought enforcement actions against companies offering prepaid cards.⁹⁷ If Congress enacts federal legislation to regulate prepaid phone cards, we believe the FTC is the most appropriate agency to issue regulations and enforce the Act.⁹⁸

As the above discussion demonstrates, there are substantial benefits to enacting legislation, either at the state or the federal level. As we discuss in Part XI, we recommend that Congress enact federal legislation. The federal law, however, should not completely preempt state law. States would still be permitted to enact legislation tailored to the special needs of their consumers as long as that state law did not conflict with the federal statute.⁹⁹

VII. Analysis of the Nature of Phone Cards and Implications for Drafting Applicable Law

In order to understand current laws regulating phone cards and draft a Model Act, it is necessary to determine the nature of phone cards. In part, the card is a payment device. It is a type of

<http://ftp.fcc.gov/cgb/consumerfacts/prepaidcards.html> (last visited Sept. 11, 2006).

⁹⁶ FTC Telemarketing Sales Rule, 16 C.F.R. § 310 (2006).

⁹⁷ *FTC v. Pt-1 Commc'ns, Inc.*, Civ. Action No. 99-1432 (S.D.N.Y. 1999) (stipulating final judgment and order for permanent injunction and consumer redress against defendant PT-1 Communications, Inc.).

⁹⁸ As discussed *infra* in Part XI, we propose that states be allowed to enact their own legislation if it is not inconsistent with the federal law. State administrative involvement may be needed if a state wishes to require sellers to register or follow the example of some states that require sellers to obtain a certificate of authority or certificate of public convenience. *E.g.*, AL. PUB. SERV. COMM'N Rule T-18.1 (2000); FLA. ADMIN. CODE ANN. r. 25-24.910 (2006); MO. CODE REGS. ANN. tit. 4, § 240-32.150(1) (2006); 815 ILL. COMP. STAT. 505/2QQ(b) (2006).

⁹⁹ Other federal consumer protection laws demonstrate how consumers can get the benefit of national coverage as well as protection for special local needs. These laws establish a national floor of minimum requirements. Rather than completely preempting state law, they permit states to enact laws that provide consumers with greater protection as long as the state's law is not inconsistent with the federal law. *E.g.*, Truth in Lending Act, 15 U.S.C. § 1666(j) (2006); Electronic Fund Transfers Act, 15 U.S.C. § 1693(q) (2006); Fair Debt Collection Practices Act, 15 U.S.C. § 1692(n) (2006).

stored value card like a prepaid gift card.¹⁰⁰ But it is also a device that accesses a service. In this respect it is analogous to an ATM card that is used to access the financial services provided by ATMs.¹⁰¹ The prepaid phone card, however, is an integral part of a transaction for the provision of telecommunications services, a very specific type of service.¹⁰²

The fact that phone cards can be characterized in a variety of ways poses difficulties for evaluating current laws and choosing a body of law that may be appropriate for a Model Act. There is no general body of law governing stored value cards. Instead states have enacted laws that are very specific to the type of card regulated (gift card, phone card, payroll card), and there is great variation among the statutes governing each type of card. The phone card is used to access a service and there is no general law governing the sale of services. Those transactions are subject to the common law of contracts.¹⁰³ Therefore, the “law” is determined by what the particular contract provides. Like an ATM card, the phone card accesses a service that can result in using the consumer’s funds. Because of that similarity, it may be appropriate to use the Electronic Fund Transfers Act, which governs ATM cards, as a model.¹⁰⁴ Indeed, the FRB re-

¹⁰⁰ Christopher B. Woods, *Stored Value Cards*, 59 CONS. FIN. QTLY. REP. 211, 211 (2005). One commentator suggests that the card issuer has special legal duties that arise from the fact that the card is prepaid. “And a fiduciary responsibility is involved for those who take money prior to providing service.” Howard Segermark, *Ensuring Fair Competition Remains Regulatory Challenge for Prepaid*, PHONE PLUS MAG., Mar. 2001, available at: <http://www.phoneplusmag.com/articles/131soap.html> (last visited Sept. 11, 2006). Segermark is Executive Director of the International Prepaid Communications Association.

¹⁰¹ ATMs can be used to perform a variety of services including cash deposits, cash withdrawals, balance inquiries, and transfers from one account to another. Candace Heckman, *Getting Money Back After ATM Theft Proving To Bank You’re A Victim Is The Hard Part*, SEATTLE POST INTELLIGENCER, Aug. 9, 2006 (describing thefts involving ATM balance inquiries and ATM withdrawals); Citibank Home Page, <http://www.citibank.com> (describing ATM features enabling customers to withdraw cash and make transfers from one account to another) (last visited Sept. 27, 2006); Bank of America Home Page, <http://www.bankofamerica.com> (describing ATM features enabling customers to make withdrawals, make transfers from one account to another, and make balance inquiries) (last visited Sept. 27, 2006).

¹⁰² See e.g., 47 U.S.C. § 251 (2006) (prescribing the duties of telecommunications carriers).

¹⁰³ E.g., *Cont’l Dredging, Inc. v. De-Kaizerred, Inc.*, 120 S.W.3d 380, 394 (Tex. Ct. App. 2003).

¹⁰⁴ The applicable law is the Electronic Fund Transfers Act, 15 U.S.C. § 1693

cently has subjected another type of stored value card, the payroll card, to the same laws as ATM cards.¹⁰⁵ Because phone cards access telecommunications services, some states incorporate selected aspects of their rules for those services.¹⁰⁶

VIII. Analysis of Current Regulation

This section analyzes the current regulation of phone cards. The analysis illustrates the wide variety of problems some states have chosen to regulate. It also demonstrates that states have not selected any uniform approach to regulating the cards. Finally, it shows that they have not used regulation of other devices, such as gift cards or ATM cards, as models for their phone card laws.

There is no uniformity in the state law regulating phone cards. States have taken a wide variety of approaches. Some have imposed minimal regulation, while others subject the industry to many specific requirements.¹⁰⁷ Some have enacted statutes, while others have issued agency regulations.¹⁰⁸ However, as Part IX discusses, even the most comprehensive state laws completely ignore major issues.

Recent studies¹⁰⁹ demonstrate the need for adequate disclosure and for clearer explanations of the costs involved in making calls. Consumers need disclosures before they purchase cards in order to decide whether to buy a card and to compare prices among cards. The studies show, however, that cost of the card is a very complex matter. Consequently, consumers need standard terms that have a universal meaning and a standard format for presenting information, much like Truth in Lending. In addition, these studies show that consumers need access to customer service representatives who can answer specific questions and explain costs.¹¹⁰

The first point of consumer contact and often principal marketing effort is advertising. Generally, advertisements do not provide

et seq.

¹⁰⁵ 71 Fed. Reg. 51437 (2006) (to be codified at 12 C.F.R. pt. 205) (Final Rule, effective July 1, 2007).

¹⁰⁶ *E.g.*, in Texas, prepaid calling card services companies are required to register with the Public Service Commission. 16 TEX. ADMIN. CODE §26.34 (2000).

¹⁰⁷ *Compare* AL. PUB. SERV. COMM'N Rule. T-18.1 (1997) (requiring only the disclosure of essential information), *with* CAL. BUS. & PROF. CODE § 17538.9(b)(1) (West 2006) (covering advertising, disclosures, refunds, and customer service).

¹⁰⁸ *Id.*

¹⁰⁹ Marlowe & Rojo, *supra* note 9, at 134-35; Marlowe, *supra* note 9, at 9.

¹¹⁰ *Id.*

as much information as is already available on the cards. Advertisements typically state the number of minutes one obtains when calling a specific city, such as Mexico City. However, advertisements may also be misleading. For example, they may state that no connection fees are charged,¹¹¹ when in fact, there are many other hidden fees. Despite its importance, the federal government has not enacted rules regulating advertisements of prepaid phone card services.¹¹² Additionally, the FTC has not aggressively enforced violations of the FTC Act in this area.¹¹³

Consumer economic literature indicates that information from advertisements is often used by consumers in establishing reference prices.¹¹⁴ These reference prices are then used at the time of purchase.¹¹⁵ Misleading advertisements may negatively affect the consumer's purchase decisions. The FTC Act and state laws require ads to be truthful and not misleading, but consumers need more legal protection than merely a law that provides that an advertisement not be misleading. Consequently, consumers need advertising provisions similar to those enacted in California, which is currently the only state with a statute specifically regulating the advertisement of phone cards.¹¹⁶ California law requires that any such advertisement "include a disclosure of any geographic limitation to the advertised price, rate, or unit value, as well as a disclosure of any additional surcharges, call setup charges, or fees or surcharges applicable to the

¹¹¹ Marlowe, *supra* note 9, at 4.

¹¹² See Federal Trade Commission, <http://www.ftc.gov>, listing all the FTC's guides and policy statements on advertising, none related directly to prepaid phone card services. (last visited Sept. 27, 2006).

¹¹³ Chester S. Galloway, Herbert Jack Rotfield & Jef I. Richards, *Holding Media Responsible for Deceptive Weight-Loss Advertising*, 107 W. VA. L. REV. 353, 383 (2005) (stating that the FTC does not have the resources to investigate many cases of deceptive advertising). The FTC, however, has brought at least one action against a phone card company. See *supra* text at note 97.

¹¹⁴ Edward A. Blair, Judy Harris & Kent B. Monroe, *Effects of Shopping Information on Consumers' Responses to Comparative Price Claims*, 78 J. OF RETAILING 76 (2002); Larry D. Compeau, Dhruv Grewal & Rajesh Chandrashedaran, *Comparative Price Advertising: Believe it or Not*, 36 J. OF CONSUMER AFF. 287-88 (2002); Valarie A. Zeithaml, *Consumer Perceptions of Price, Quality, and Value: A Means-End Model and Synthesis of Evidence*, 52 J. OF MARKETING 2-3 (1988).

¹¹⁵ Blair, Harris & Monroe, *supra* note 114, at 76.

¹¹⁶ Truth in Lending imposes requirements for ads that mention specific credit terms. 12 C.F.R. § 226.24 (2006).

advertised price, rate, or unit value.”¹¹⁷

On the other hand, a law requiring advertisements to include certain information is not sufficient either. Some consumers purchase cards without seeing an advertisement. Others who see ads also need information at the point of purchase. Such consumers may not remember the information in the advertisement, or they may remember it incorrectly. Furthermore, consumers need much more information than any advertisement could adequately convey. As a result, many of the states that regulate phone cards require disclosures at the point of purchase.¹¹⁸

Most states that regulate phone cards require very specific information to be disclosed on the card itself. One could argue that these laws are much too detailed, and that consumer choice in this competitive market should determine what information should be disclosed. However, the information that states require to be disclosed at the point of purchase reflects the problems consumers have encountered using the cards. The seller must print the name of the company on the phone card.¹¹⁹ Consumers need this information in order to contact the company when necessary, to complain about the company to law enforcement and to sue if a dispute cannot be resolved. State laws require the seller to print a toll-free customer service number on the card as well.¹²⁰ As studies show, consumers of this product need access to customer service.¹²¹ They often have rea-

¹¹⁷ CAL. BUS. & PROF. CODE § 17538.9(b)(1) (West 2006).

¹¹⁸ States require disclosures on the card itself. *See e.g.*, CAL. BUS. & PROF. CODE § 17538.9(b)(2)(A) (West 2006). Some states require other disclosures on the card or its packaging. *See e.g.*, *Id.* § 17538.9(b)(3).

¹¹⁹ CAL. BUS. & PROF. CODE § 17538.9(b)(2)(A) (West 2006). California law defines “company” as “an entity providing prepaid calling services to the public using its own or a resold telecommunications network.” CAL. BUS. & PROF. CODE at § 17538.9(a)(1) (West 2006). Other states that require the name of the company on the card include the following: Alaska, *see* ALASKA ADMIN. CODE tit. 3, § 52.377(d)(1)(A) (2006); Alabama, *see* AL. PUB. SERV. COMM’N Rule. T-18.1 (1997); Florida, *see* FLA. ADMIN. CODE ANN. r. 25-24.920(1)(a) (2006); Illinois, *see* 815 ILL. COMP. STAT. 505/2QQ(d)(1)(A) (2006); Missouri, *see* MO. CODE REGS. ANN. tit. 4, §240-32.150(2) (2006); New York, *see* N.Y. PUB. SERV. LAW § 92-f(2)(a) (McKinney 2006); Texas, *see* 16 TEX. ADMIN. CODE §26.34(f)(1)(B)(ii) (2000); and Washington, *see* WASH. ADMIN. CODE 480-120-264(5)(a)(ii) (2006).

¹²⁰ CAL. BUS. & PROF. CODE § 17538.9(b)(2)(B) (West 2006); FLA. ADMIN. CODE ANN. r. 25-24.920(1)(b) (2006); ILL. COMP. STAT. 815 505/2 QQ (d)(1)(B) (2006); MO. CODE REGS. ANN. tit. 4, §240-32.160(2)(B) (2006); N.Y. PUB. SERV. LAW § 92-f(2)(b) (McKinney 2006); 16 TEX. ADMIN. CODE §26.34(f)(1)(A)(i) (2000).

¹²¹ Marlowe & Rojo, *supra* note 9, at 134-35; Marlowe, *supra* note 9, at 9.

sonable questions, given the nature of the services provided. Because of the low cost of each card, requiring the seller to provide a customer service number that is not toll-free would discourage consumers from contacting customer service.

Some state laws also require the card seller to disclose a toll-free network access number if such a number is required in order to access service.¹²² Fundamental fairness requires the seller to inform the consumer of that number. For the seller not to disclose it would amount to fraud as the seller would have the consumer's money, but the consumer would not have any service. Requiring the number to be toll-free is justified because the access number merely permits the consumer to gain access to the system. Charges should not be imposed unless and until the consumer actually makes a call. The card also must disclose the authorization code if it is required to access service.¹²³ As with the requirement that the card contain the access number, failure to disclose the authorization code would be fraudulent since the consumer would have paid but would then be unable to make any calls.¹²⁴ Finally, states require the card to include the expiration date or policy, if any.¹²⁵ In California, Florida, Missouri, and New York, cards that do not include this information are considered to be active for at least one year from the date of purchase or the date of the last recharge.¹²⁶ In the state of Washington, if an expiration date is not disclosed on the card, it is considered "unexpired indefinitely."¹²⁷

¹²² CAL. BUS. & PROF. CODE § 17538.9(b)(3)(C) (West 2006); FLA. ADMIN. CODE ANN. r. 25-24.920(1)(c) (2006); 815 ILL. COMP. STAT. 505/2 QQ (d)(1)(C) (2006); MO. CODE REGS. ANN. tit. 4, § 240-32.160(2)(C) (2006); N.Y. PUB. SERV. LAW § 92-f(2)(c) (McKinney 2006).

¹²³ CAL. BUS. & PROF. CODE § 17538.9(b)(2)(D) (West 2006); FLA. ADMIN. CODE ANN. r. 25-24.920(1)(d); MO. CODE REGS. ANN. tit. 4, § 240-32.160(2)(D) (2006); N.Y. PUB. SERV. LAW § 92-f(2)(d) (McKinney 2006).

¹²⁴ The situation is analogous to the person who issues a check drawn on an account that doesn't exist or that contains no funds, providing the payee with an action in deceit. *See* Greenfield, *supra* note 75, at 12.

¹²⁵ CAL. BUS. & PROF. CODE § 17538.9(b)(3)(I) (West 2006); FLA. ADMIN. CODE ANN. r. 25-24.920(2)(c) (2006); 815 ILL. COMP. STAT. § 505/2 QQ (d)(2)(F) (2006); MO. CODE REGS. ANN. tit. 4, § 240-32.160(1)(C) (2006); N.Y. PUB. SERV. LAW § 92-f(2)(e) (McKinney 2006); 16 TEX. ADMIN. CODE § 26.34(f)(1)(B)(iv) (2000); WASH. ADMIN. CODE 480-120-264(5)(a)(v) (2006).

¹²⁶ CAL. BUS. & PROF. CODE § 17538.9(b)(8) (2006); FLA. ADMIN. CODE ANN. r. 25-24.920(7) (2006); MO. CODE REGS. ANN. tit. 4, § 240-32.170(8) (2006); N.Y. PUB. SERV. LAW § 92-f(6) (McKinney 2006).

¹²⁷ WASH. ADMIN. CODE 480-120-264(5)(a)(v) (2006). Texas has the same

Other disclosures must be made either on the card or the packaging that comes with the card. It is necessary to give card sellers this choice because phone cards are small and all the required information may not fit. The manner of presentation is also important for disclosure to be meaningful. California, for example, requires the disclosure to be legible.¹²⁸ In addition, the required information must be made “available clearly and conspicuously in a prominent area immediately proximate to the point of sale of the . . . calling services.”¹²⁹ In Florida, if disclosures are not on the card or packaging, they must be displayed “visibly in a prominent area at the point of sale . . . in such a manner that the consumer may make an informed decision prior to purchase.”¹³⁰

In California, the required disclosures on the card or packaging include the “value of the card” as well as any surcharges, taxes or fees.¹³¹ The California statute provides a list of fees, illustrating the complexity of the product’s pricing, and how sellers use a variety of different terms, all of which amount to additional cost to the consumer.¹³² Further, there are different requirements for disclosing surcharges for international calls.¹³³ The seller also must disclose the minimum charge per call, the billing decrement, the recharge policy, if any, and the refund policy, if any.¹³⁴

There is no national uniform format for disclosures on phone cards, unlike disclosure for credit and debit card transactions.¹³⁵ California, however, has tried to impose some uniformity on cards sold to consumers in its state.¹³⁶ The statute requires the value of the

policy; if the expiration date or policy is not disclosed, on the card, it is considered active “indefinitely.” 16 TEX. ADMIN. CODE § 26.34(f)(1)(B)(iv) (2000).

¹²⁸ CAL. BUS. & PROF. CODE § 17538.9(b)(3) (West 2006).

¹²⁹ *Id.*

¹³⁰ FLA. ADMIN. CODE ANN. r. 25-24.920(2) (2006).

¹³¹ CAL. BUS. & PROF. CODE § 17538.9(b)(3) (West 2006).

¹³² Fees include “monthly or other periodic fees, maintenance fees, per-call access fees, surcharges for calls made on pay telephones, or surcharges for the first minute or other period of use....” *Id.* § 17538.9(b)(3)(A).

¹³³ *Id.* § 17538.9(b)(3)(B).

¹³⁴ *Id.* Illinois’ and New York’s requirements on disclosure of fees are similar. 815 ILL. COMP. STAT. § 505/2QQ(D)(2) (2005); N.Y. PUB. SERV. LAW § 92-f(3) (McKinney 2006).

¹³⁵ 12 C.F.R. § 22612 (1994) (regarding credit cards); 12 C.F.R. § 205.4 (2001) (regarding debit cards).

¹³⁶ CAL. BUS. & PROF. CODE § 17538.9(b)(13) (West 2006).

card and the amount of the charges to be disclosed on the card or its packaging all in the same format.¹³⁷ Moreover, if the value of the card is expressed in minutes, those minutes must be designated as either domestic or international.¹³⁸ Finally, that designation must be printed on the same line as the value of the card in minutes or on the line immediately following.¹³⁹

In addition to written disclosures at the point of sale, Texas requires verbal disclosures at the beginning of each call.¹⁴⁰ The consumer must be told the “domestic minutes, billing increments, or dollars remaining” on the prepaid account or card.¹⁴¹ In addition, when the balance on the credit card is almost depleted the company must provide a verbal announcement of that fact “at least one minute or billing increment before the time expires.”¹⁴²

California law recognizes that many sellers target specific ethnic groups.¹⁴³ It requires that if a language other than English is used in the advertising or promotion of the card, or is used on the card or packaging (other than for dialing instructions), the required information on the card or packaging must also be disclosed in the language used to advertise or promote the card.¹⁴⁴ If a language other than English is used on the card or packaging to provide dialing instructions for making a call or reaching customer service, the additional information required on the card or packaging must be disclosed in the language used to provide the dialing instructions or to reach customer service.¹⁴⁵ Similarly, Texas requires that if a card is marketed in a language other than English, certain disclosures must be made in the same language.¹⁴⁶ Bilingual cards are permitted as long as all of the required information is in both languages.¹⁴⁷

Laws which require sellers of prepaid telephone cards to provide a toll-free telephone number for customer service, and which es-

¹³⁷ *Id.*

¹³⁸ *Id.*

¹³⁹ *Id.*

¹⁴⁰ 16 TEX. ADMIN. CODE § 26.34(g)(1) (2000).

¹⁴¹ *Id.*

¹⁴² *Id.* § 26.34(g)(2) (2000).

¹⁴³ CAL. BUS. & PROF. CODE § 17538.9(b)(4) (West 2006).

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ 16 TEX. ADMIN. CODE § 26.34(f)(1) (2000).

¹⁴⁷ *Id.*

establish requirements for that service are perhaps unique in the law of payment systems. If a person pays for goods and services with a check, the Uniform Commercial Code (UCC) does not require banks to provide any kind of customer service despite the importance of the financial services they provide.¹⁴⁸ If the consumer pays using a credit card or debit card, federal law imposes certain error resolution procedures, but the seller of such cards is not required to provide a phone number for contacting the seller.¹⁴⁹ The seller is required only to resolve disputes, not provide information.¹⁵⁰ Phone cards are a type of stored value card. Many states regulate another type of stored value card, the gift card, but no gift card laws require sellers to provide consumers access to customer service, much less toll-free access.¹⁵¹ Thus, those states having phone card laws requiring the seller to provide a toll-free customer service number are going beyond what is normally mandated in consumer protection legislation.¹⁵²

Requiring the seller to disclose a toll-free customer service number does not help consumers unless informed customer service representatives are available to answer the consumers' questions. The studies discussed previously illustrate the difficulties consumers have obtaining needed information from customer service.¹⁵³ States vary in the degree to which they impose quality standards for customer service. California and New York have the most consumer-friendly requirements. The seller's customer service line must have live operators to answer calls twenty-four hours a day, seven days a week.¹⁵⁴ Other states provide that the seller must have a live operator available or must record consumer calls and have a live operator return the call within a specified period of time.¹⁵⁵

¹⁴⁸ See U.C.C. § 4-406 (2002) (requiring customers to report check forgeries and alterations to the bank, and if timely reported the non-negligent customer is not liable, but the UCC does not require any dispute resolution procedure. If the bank refuses to investigate the customer's claim and recredit the customer's account, the customer's only recourse is to sue. The bank's refusal to investigate and recredit does not violate the UCC).

¹⁴⁹ 12 C.F.R. § 226.13 (1994) (regarding credit cards); 12 C.F.R. § 205.11 (2001) (regarding debit cards).

¹⁵⁰ *Id.*

¹⁵¹ Budnitz & Saunders, *supra* note 81, at 178-79.

¹⁵² *Id.*

¹⁵³ Marlowe & Rojo, *supra* note 9, at 130-31.

¹⁵⁴ CAL. BUS. & PROF. CODE § 17538.9(b)(6) (West 2006); N.Y. PUB. SERV. LAW § 92-f(4) (McKinney 2000).

¹⁵⁵ See, e.g., AL. PUB. SERV. COMM'N Rule T-18.1(5) (2000) (requiring that

In some states, phone card laws go further than what is required in most consumer protection statutes by setting minimum performance standards for the services that customer service must provide. For example, California and New York require the operator to permit consumers to file complaints.¹⁵⁶ In addition, the operator must be able to provide consumers with information about rates, surcharges, fees, policies on recharging cards, refunds, expiration dates, and the balance of usable minutes still available in the consumer's account.¹⁵⁷

A few states have gone beyond disclosure and customer service by providing substantive protection as well. They impose detailed requirements on charges and fees.¹⁵⁸ These include mandating rules for rounding up to the next minute and prohibiting sellers from excessive rounding up.¹⁵⁹ Some laws provide that the value of the card cannot be reduced by more than the charges printed on the card or the packaging or display at the point of sale.¹⁶⁰

State statutes also impose a wide variety of refund requirements. California and New York require sellers to give the consumer a refund if the service fails to operate in a "commercially reasonable manner."¹⁶¹ Although this is a vague standard, the statutes at least establish that consumers are entitled to refunds.¹⁶² In Florida, consumers are entitled to a refund if service is "rendered unusable for reasons beyond the consumer's control."¹⁶³ Missouri requires a refund if the

customer service be manned 8 hours per day, five days per week); FLA. ADMIN. CODE ANN. r. 25-24.920(4) (2006) (requiring live operator 24/7 or electronically recorded and attempt to contact the next business day); MO. CODE REGS. ANN. tit. 4, § 240-32.140(4) (2001) (requiring availability 24/7); 16 TEX. ADMIN. CODE § 26.34(i) (2000) (requiring live operator 24/7 or electronically recorded and attempt to contact the next business day); WASH. ADMIN. CODE 480-120-264(2)(a) (2003) (requiring ability to respond 24/7).

¹⁵⁶ CAL. BUS. & PROF. CODE 17538.9(b)(6)(B) (West 2006); N.Y. PUB. SERV. LAW § 92-f(4) (McKinney 2006).

¹⁵⁷ N.Y. PUB. SERV. LAW § 92-f(4) (McKinney 2006). New York also requires that the operator be able to provide information about the "terms and conditions of service and monthly service charges." *Id.* § 92-f(4)(iv).

¹⁵⁸ FLA. ADMIN. CODE ANN. r. 25-24.920(9) (2006); CAL. BUS. & PROF. CODE § 17538.9(b)(7) (West 2006); N.Y. PUB. SERV. LAW § 92-f(5) (McKinney 2006).

¹⁵⁹ FLA. ADMIN. CODE ANN. r. 25-24.920(9) (2006).

¹⁶⁰ CAL. BUS. & PROF. CODE § 17538.9(b)(7) (West 2006); N.Y. PUB. SERV. LAW § 92-f(5) (McKinney 2006).

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ FLA. ADMIN. CODE ANN. r. 25-24.925(1)(a) (2006).

company ceases operations¹⁶⁴ or can no longer provide service.¹⁶⁵ Alabama requires a refund if service is suspended.¹⁶⁶ Texas requires a refund if the company fails to provide service at the disclosed rates or the service fails to meet technical standards.¹⁶⁷ Florida requires companies to have a refund policy.¹⁶⁸ At a minimum, such a policy must provide for the consumer to receive a refund if the prepaid calling service is “unusable for reasons beyond the consumer’s control” and the services “have not [exceeded] the expiration period.”¹⁶⁹ Furthermore, the refund must be for the same amount as the value still on the card.¹⁷⁰ Alaska requires a refund if the card does not work as represented or the required disclosures are not made to the customer.¹⁷¹ In addition, the Regulatory Commission of Alaska can direct that a refund be paid “for good cause.”¹⁷² In Florida, a company “may, but shall not be required to” provide a refund for lost or stolen cards.¹⁷³ States also require that the amount of the refund cannot be less than the value remaining on the card.¹⁷⁴ The refund must be provided within 60 days from the date the consumer notifies the company.¹⁷⁵

Some of the states that have enacted prepaid phone card laws

¹⁶⁴ MO. CODE REGS. ANN. tit. 4, § 240-32-170(5)(B) (2006).

¹⁶⁵ *Id.* § 240-32-170(6)(A).

¹⁶⁶ AL. PUB. SERV. COMM’N Rule T-18.1(4) (1998).

¹⁶⁷ 16 TEX. ADMIN. CODE § 26.34(j) (2000).

¹⁶⁸ FLA. ADMIN. CODE ANN. r. 25-24.925 (1)(a).

¹⁶⁹ *Id.*; see also MO. CODE REGS. ANN. tit. 4, § 240-32.170(6) (2006) (requiring a company to refund the unused value remaining on the card if the “company is no longer able to provide service.”)

¹⁷⁰ FLA. ADMIN. CODE ANN. r. 25-24.925(1)(a) (2006). The company can choose whether to make the refund in cash or by means of a replacement service. It must be provided within 60 days of when the consumer notifies the company. *Id.* r. 25-24.925(1)(b).

¹⁷¹ ALASKA ADMIN. CODE tit. 3, § 52.377(e) (2006).

¹⁷² *Id.*

¹⁷³ FLA. ADMIN. CODE ANN. r. 25-24.925(2) (2006). Compare the rules for lost and stolen credit cards. Under federal law, a consumer has a maximum liability of \$50. The liability will be less if the consumer notifies the card issuer before the thief charges less than \$50 prior to the consumer providing the notification. 12 C.F.R. § 226.12(b) (2006).

¹⁷⁴ CAL. BUS. & PROF. CODE § 17538.9(b)(7) (West 2006); FLA. ADMIN. CODE ANN. r. 25-24.925(1)(a) (2006); MO. CODE REGS. ANN. tit. 4, § 240-32.170(6)(A) (2006); N.Y. PUB. SERV. LAW § 92-f(5) (McKinney 2006).

¹⁷⁵ *Id.*

have also imposed performance standards such as a minimum level of operational capacity for the service being provided. These requirements are in sharp contrast to the law governing other payment devices¹⁷⁶ as well as the laws governing the quality of goods and services.¹⁷⁷

In California, companies must “maintain access numbers with sufficient capacity to accommodate a reasonably anticipated number of calls without incurring a busy signal or undue delay.”¹⁷⁸ Apparently, failure to maintain that capacity would trigger California’s requirement that consumers are entitled to a refund if a company fails to provide service in a commercially reasonable manner.¹⁷⁹ Case law from other types of transactions may be useful in further defining what circumstances may be commercially unreasonable.¹⁸⁰ Florida law formerly required that every company ensure that at least 95 percent of all call attempts to the company’s toll-free customer service number be completed.¹⁸¹ Finally, there must be at least 97 percent accuracy of the length of the conversation.

Another substantive protection relates to expiration policies. For example, California, Florida, and New York provide that if the card does not state a specific expiration date or policy, a card is considered active for at least one year from the date of purchase.¹⁸² In addition, if the card has been recharged, it must be active for one year from the date of the last recharge.¹⁸³ Sellers who consider the one

¹⁷⁶ Credit card law provides a limited remedy if there is a failure in the goods or services purchased. Consumers can dispute the charges and refuse to pay for those goods or services. 12 C.F.R. § 226.12(c) (2006). The card issuer will charge the amount back to the merchant and leave the consumer and merchant to resolve the dispute on their own. Budnitz & Saunders, *supra* note 81, at 152. Debit card law does not provide any remedy. *Id.* at 82.

¹⁷⁷ In regard to the sale of goods, the Uniform Commercial Code includes rules on express and implied warranties, but a merchant can avoid these by disclaiming them in the contract between the parties. U.C.C. § 2-316 (2003). The federal Magnuson-Moss Warranty Act provides limited protection. 15 U.S.C. §§ 2301-2312 (2006). The warranty laws regarding the provision of services are even more problematic. *See infra* at Part IX.

¹⁷⁸ CAL. BUS. & PROF. CODE § 17538.9 (b)(10) (West 2006).

¹⁷⁹ *Id.* § 17538.9 (b)(7).

¹⁸⁰ Many laws require parties to act in a commercially reasonable manner. *See, e.g.*, U.C.C. §§ 3-103(a)(6)-(9) (2002), 9-607(c), 9-608(a)(3), 9-610 (2000).

¹⁸¹ FLA. ADMIN. CODE ANN. r. 25-24.930 (repealed 2005).

¹⁸² CAL. BUS. & PROF. CODE § 17538.9(b)(8) (West 2006); N.Y. PUB. SERV. LAW § 92-f(6) (McKinney 2006).

¹⁸³ N.Y. PUB. SERV. LAW § 92-f(6) (McKinney 2006).

year minimum onerous can easily avoid its imposition simply by providing on the card that it expires within a shorter period of time.¹⁸⁴ However, if the seller establishes an expiration date that is too short, for example one week, the consumer may be able to convince a court that the expiration date is unconscionable, in bad faith, or commercially unreasonable.¹⁸⁵ Statutes do not impose a minimum period before a card expires.

State statutes and regulations of phone cards do not include specific provisions providing that consumers can sue the card companies for violating these laws. Nevertheless, consumers in some states may be able to sue under their “mini-FTC” acts, alleging that a violation of the phone card requirements constitutes a deceptive or unfair act or practice.¹⁸⁶ In other states, consumers may confront substantial barriers.¹⁸⁷ A government agency, such as the state’s public service commission, may be authorized to impose penalties for violation of the phone card laws,¹⁸⁸ but consumers have no assurance they will do so, especially if the commission lacks sufficient resources or strong proof that violations are widespread.

¹⁸⁴ *Id.*

¹⁸⁵ *See generally* Borowski v. Firststar Bank Milwaukee, 579 N.W.2d 247 (Wis. Ct. App. 1998) (upholding a bank’s contract requiring a customer to notify the bank of any unauthorized signature or alteration of a check within 14 days as reasonable, and rejecting the dissent’s view that such a short time period was contrary to customers’ reasonable expectations and conduct).

¹⁸⁶ Greenfield, *supra* note 75, at 160 (describing how legislation prohibiting deceptive practices has been enacted in every state). *See also, id.* at 559 (most states have prohibited unfair practices).

¹⁸⁷ *See, e.g.,* Taylor v. Jacques, 292 B.R. 434, 434 (Bankr. N.D. Ga. 2002)(holding that consumer cannot sue under Georgia’s Fair Business Practices Act if the industry is regulated, even if the regulations do not address the problem the consumer alleges violates the Act). Consumers also face formidable barriers to obtaining judicial relief if a company stops doing business. Alternatively the company may stop doing business in one state, then resume business in another state under a different name. *See generally*, Pickel, *supra* note 7 (reporting that companies lose consumer loyalty with their unfair and deceptive practices, but then market the cards with a new brand name, cheating consumers who do not realize it is the same company).

¹⁸⁸ 16 TEX. ADMIN. CODE § 26.34(m) (2000)(explaining that the commission can order the company to take corrective action, impose administrative penalties, and coordinate with the Office of the Attorney General).

IX. The Inadequacy of Warranty Law

The UCC includes provisions on express and implied warranties that may be beneficial to consumers who purchase goods.¹⁸⁹ The UCC, however, does not apply to the sale of services, which would include the sale of telephone services. The federal Magnuson-Moss Warranty Act prohibits the disclaimer of implied warranties once a seller provides a written warranty.¹⁹⁰ Unfortunately, the Act does not apply to the sale of services either.¹⁹¹

Because neither the UCC nor the Magnuson-Moss Warranty Act applies to the sale of phone services, general contract law applies. Under contract law, courts will enforce express warranties. The seller, however, can avoid that result by carefully drafting the contract so it does not include any express warranties regarding the quality of the service provided to the consumer. Some courts have held that service contracts include implied warranties.¹⁹² The cases, however, do not involve provisions of telephone services or comparable services.¹⁹³ Consequently, it is not at all clear how courts would apply those standards to prepaid phone service. Moreover, sellers most likely can avoid enforcement of the implied warranties by disclaiming them.¹⁹⁴

¹⁸⁹ Once a seller makes an express warranty, it cannot disclaim that warranty. U.C.C. § 2-316(1)(2003). However, the seller is not required to make any express warranties. Certain implied warranties arise by operation of law, U.C.C. § 2-314 & 2-315 (2003), but the seller can easily disclaim these. U.C.C. § 2-316(2) & (3) (2003).

¹⁹⁰ 15 U.S.C. § 2308(a) (2006).

¹⁹¹ 16 C.F.R. § 700.1(h) (2006). Even if the Act did apply, the Act prohibits only the disclaimer of implied warranties that are created by state law; the Act itself does not create any implied warranties.

¹⁹² “. . . [A] duty is implied in every service, repair or construction contract to perform it skillfully, carefully, diligently, and in a workmanlike manner.” *Alco Standard Corp. v. Westinghouse Elec. Corp.*, 206 Ga. App. 794, 796, 426 S.E.2d 648, 650 (Ga. Ct. App. 1992).

¹⁹³ *Id.*

¹⁹⁴ No cases were found addressing this issue, but since the UCC permits disclaimers of implied warranties for the sale of goods, presumably courts also would allow it for the sale of services. See generally Richard M. Alderman, *Warranty Disclaimers and the Texas Deceptive Practices Act*, 29 HOUS. LAW. 14, 15 (Jan./Feb. 1992) (discussing express warranty disclaimers in service contracts).

X. Problems Not Addressed in Regulations

As described above, while most states have not regulated phone cards at all, some which have enacted regulations have gone far beyond the protection accorded consumers using other types of payment devices. However, even the states with the most comprehensive regulations have failed to do anything to protect consumers who confront many serious problems. In order for our Model to accomplish its objective, it was necessary to identify the gaps in current law.

For example, regulations include many required disclosures,¹⁹⁵ but do not require sellers to inform consumers of their policy with regard to unilaterally changing the terms and conditions of providing service without prior notice to the consumer.¹⁹⁶ Statutes do not require disclosure of the seller's policy on lost, stolen, unauthorized, or malfunctioning cards.¹⁹⁷ Finally, statutes do not require sellers to inform consumers whether they can redeem unused value on their card, and if they can, how it can be redeemed and what charges may be imposed.¹⁹⁸

Statutes also fail to provide consumers with any protection if a card is lost or stolen.¹⁹⁹ In addition, consumers may lose the piece of paper or other record on which they have written their Personal Identification Number (PIN) and may not have their PIN memorized.²⁰⁰ Without the PIN, the card cannot be used and the consumer loses the value of the balance remaining on the card.²⁰¹ State law is deficient in not requiring the seller to replace the PIN. At the very least, statutes should require a warning to consumers about the con-

¹⁹⁵ See Budnitz & Saunders, *supra* note 81, at 177-178.

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

¹⁹⁹ See FLA. ADMIN. CODE ANN. r. 25-24.925(2)(providing that a company "may, but shall not be required to, provide a refund" for lost or stolen phone cards). Compare credit card and debit card law that imposes specific caps that limit the consumer's liability if a thief makes charges on a lost or stolen card. 15 U.S.C. § 1643(a) (2006) (credit cards); *Id.* § 1693(g) (debit cards and other electronic fund transfers).

²⁰⁰ See Cheryl Johnson, *Faux Williams makes rounds; Star impersonator leaves trail of angry victims*, STAR TRIB., Dec. 26, 2004 (reporting consumer's allegations of unauthorized use of phone card after he lost the piece of paper on which he had written his PIN).

²⁰¹ *Id.*

sequences of losing their PIN. If the consumer cannot remember the PIN and the seller refuses to inform the consumer what the PIN is, or issue a new PIN, the balance of unused value remaining on the card becomes pure profit for the card issuer.²⁰²

A card may also be defective. For example, the access number or the PIN may not work,²⁰³ or the card may have some other defect making it impossible to operate as it should.²⁰⁴ Consumers will lose the entire balance on the card if the card issuer refuses to replace the card. Statutes do not require card issuers to replace cards. Even if the issuer does replace cards, it may charge such a high fee that it is not economically advisable for consumers to purchase a replacement.

Additionally, the card issuer may go out of business.²⁰⁵ The issuer may simply close its doors and disappear. Statutes provide purchasers of phone cards with no satisfactory remedy when this occurs. Alternatively, the issuer may file for bankruptcy, leaving consumers with unsecured claims that are unlikely to be satisfied.

States do not regulate the amount of charges and fees. Rather, states require an issuer who charges fees for various services, to inform consumers about the fees.²⁰⁶ However, the disclosure requirements of state laws are not adequate. For example, states do not require sellers to inform consumers of the extra charges they incur if

²⁰² The card issuer may be required to transfer those funds to the state under abandoned property or escheat laws. Christopher B. Woods, *Stored Value Cards*, 59 CONSUMER FIN. L. Q. REP. 211, 219 (2005); Anita Ramasastry, *State Escheat Statutes and Possible Treatment of Stored Value, Electronic Currency, and Other New Payment Mechanisms*, 57 BUS. LAW. 475, 480-81 (2001) (stating that North Carolina and Arizona exclude prepaid phone cards from their escheat laws). Even where those laws apply to prepaid phone balances, the seller has the use of those funds until they are paid to the state.

²⁰³ Marlowe & Rojo, *supra* note 9, at 130.

²⁰⁴ Luna, *supra* note 18 (highlighting an instance where a consumer reported that her card was cut off immediately after making her first call, and the card did not work thereafter). The New York Attorney General persuaded eighteen retailers to agree to deactivate and reissue damaged gift cards. *Big Retailers Agree to Replace Gift Cards*, DETROIT FREE PRESS, Mar. 3, 2003.

²⁰⁵ See <http://www.ftc.gov/bcp/online/pubs/products/buytime.htm>; <http://www.fcc.gov/cgb/consumerfacts/prepaidcards.html>; see also Mark E. Budnitz, *Stored Value Cards and the Consumer: The Need for Regulation*, 46 AM. U. L. REV. 1027, 1035, n. 54 (1997) (reporting that issuers of prepaid phone cards have gone out of business after selling tens of thousands of cards which thereafter became worthless).

²⁰⁶ See Getting the Best Value from Prepaid Phone Cards, Consumer Action (April 1, 2001), available at <http://www.consumeraction.org> (last visited Oct. 5, 2006).

they use their phone card at a pay phone.²⁰⁷

In states that have no laws regulating phone cards, the rights and obligations of the parties are governed by the contract between the card issuer and the consumer. In states with phone card laws, the many matters not regulated are subject to the terms of the contract. The contracts between issuers and consumers are not the result of a negotiated bargain between the parties, and, in fact the consumer never even signs the agreement. Rather, the law deems that consumers agree to the terms of the take-it-or-leave-it adhesion contracts by paying their money and using the card. The cards often include unilateral change of terms provisions under which the issuers can modify the contract's terms without notice to consumers.²⁰⁸ Those changes could deprive consumers of important rights they had under the contract when they originally bought the card or impose substantial new charges upon them. States have not enacted laws specifically governing this problem.

Finally, even states that have enacted strong phone card laws do not include in those statutes provisions granting consumers explicit causes of action and meaningful remedies for violation of the law such as those included in federal consumer protection statutes.²⁰⁹ This is a serious omission that may make the protections in the laws largely illusory.

The Model Act described in the following section fills the gaps in current law by including provisions to deal with the issues identified above, that statutes do not address.

XI. Model Prepaid Telephone Card Act

Based on the foregoing analysis of the problems consumers of prepaid telephone cards encounter, the information they need, the nature of the marketplace, the dismal prospects for self-regulation, and the inadequacy of the states' responses to date, we propose that Congress enact a federal law to regulate phone cards. As discussed previously,²¹⁰ a federal statute provides benefits to both the industry and consumers that state laws cannot offer. Matters not included in the

²⁰⁷ *Id.*

²⁰⁸ Budnitz & Saunders, *supra* note 81, at 172-173. *See infra* text accompanying note 200.

²⁰⁹ *See, e.g.*, the Electronic Fund Transfers Act, 15 U.S.C. § 1693(m) (2006) (providing actual damages, statutory damages, costs, and reasonable attorney's fees).

²¹⁰ *See infra* Part VI.

federal statute are appropriate for individual states to adopt if they see fit to do so. Our proposal breaks very little new ground. Rather we have taken those features of state law that offer consumers needed protection and recommend that they be incorporated into a federal law. Most of our suggestions represent approaches that states have already adopted. Therefore, it is reasonable to assume that they pose no significant technological or financial impediments to the prepaid phone card industry.

Our Model Act covers those matters that should be governed by a federal statute. Some matters are not included in our Model Act because we believe they are best left for the states to consider on an individual basis. These matters include licensing and registration of companies selling cards, the needs of residents with special needs, as well as regulation of rates and fees. If Congress refuses to pass phone card legislation, our Model Act should be enacted by each state.

The federal statute should establish a basic framework that ensures consumers a reasonable level of disclosure and protection. The statute should delegate to the FTC the task of issuing detailed regulations pursuant to the statute, filling in the details and responding to future changes in technology, marketing, and the marketplace.²¹¹ To assist card issuers in complying with the law and to reduce compliance costs, the statute should instruct the FTC to draft model disclosure forms for issuers to use if they wish.²¹² States would be permitted to enact their own laws as long as they were not inconsistent with the federal statute.²¹³

The federal statute should also regulate disclosures in advertising. As previously noted,²¹⁴ advertising is important in inducing

²¹¹As discussed above, the FRB and FCC might be appropriate agencies as well. *See supra* text accompanying notes 89-94. The FTC, however, seems best suited. The FRB deals with financial institutions, and sellers of phone cards are not financial institutions. The FCC's focus is on the telecommunications industry, not on payment devices such as phone cards, or the types of problems consumers face when they use phone cards.

²¹²As provided in other statutes, using the agency-approved form would be deemed compliance with the disclosure requirements. Electronic Fund Transfers Act, 15 U.S.C. § 1693(m)(d)(2) (2006).

²¹³*See* Electronic Fund Transfers Act, 15 U.S.C. § 1693(q) (2006) The Act does not annul, alter, or affect state law except to the extent it is inconsistent with the Act. Furthermore, a state law is not inconsistent if it affords consumers greater protection than is provided in the Act.

²¹⁴*See supra* text accompanying note 108. *See also* FTC v. Pt-1 Commc'ns, Civ. Action # 99-1432 (S.D.N.Y. 1999)(stipulated final judgment and order for permanent injunction and consumer redress; permanent injunction in connection

consumers to buy a certain brand of card. In addition, a federal law is appropriate because a radio or television commercial or Internet ad can be seen and heard across state borders. The federal law should incorporate the provisions of California's law that requires phone card advertisements to disclose geographic limits to the advertised price, rate, or unit value, as well as to disclose additional surcharges, call setup charges, or fees applicable to the advertised price, rate, or unit value.²¹⁵ The FTC should be authorized to issue additional disclosures from time to time if it finds they are needed. This flexibility is appropriate given the new advertising avenues that emerging technologies continue to make possible.²¹⁶

The federal law should require disclosures that are available to consumers prior to purchasing prepaid phone cards. Disclosure plays a crucial role in phone card transactions because of the manner in which consumers become bound by the terms of the contract. As is evident from the discussion in this article, the purchase and use of phone cards involves many elements. Some of the features of this service are complex and confusing, such as the calculation of fees and charges. Consumers and card issuers do not enter into a formal written contract that includes the terms of agreement, with consumers expressing their agreement to be bound in some manner, such as signing the contract. Instead, the card issuer notifies the consumer of rights, obligations, restrictions, limitations, and conditions on the card or in the packaging, and the consumer purchases the card. Therefore, the consumer does not participate in the negotiation of the terms. Courts uphold the enforceability of these types of contracts, finding that consumers have accepted and are bound by any terms of which they have notice if they use the product after having opportunity to discover those terms.²¹⁷ In order to ensure the fairness and reason-

with phone card company's advertising). *See also* Hispanic Outreach Forum & Law Enforcement Workshop: A Summary of the Proceedings, *supra* note 82, at 9 (discussing how phone cards and other various types of media, excluding direct mail, are sources of deceptive claims targeted at Hispanics).

²¹⁵CAL. BUS. & PROF. CODE § 17538.9(b)(1) (West 2006).

²¹⁶*See* Federal Trade Commission, *Facts for Business: DotCom Disclosures*, available at <http://www.ftc.gov/bcp/online/pubs/buspubs/dotcom> (last visited May 31, 2006).

²¹⁷*See e.g.*, *Boomer v. AT&T Corp.*, 309 F.3d 404 (7th Cir. 2002) (holding that the consumer accepted a contract when using the service after he received agreement). *See generally* Ronald J. Mann, *Panel One: Boilerplate In Consumer Contract: "Contracting" For Credit*, 104 MICH. L. REV. 899, 910 (2006) (discussing the credit card issuer's use of contract terms providing that notice and continued use bind consumers when issuers unilaterally change contract terms). As Howard Segermark, the Executive Director of the International Prepaid Communi-

ableness of the terms that bind the parties, it is essential that the law require certain disclosures that become part of the contract.

The federal law should require certain disclosures on the card itself. This includes the name of the company issuing the card and a toll-free customer service number. The card also should give a toll-free network access number if that is required in order to access service. The card must disclose the authorization code if one is required to access service. Most states that have enacted legislation include these disclosure requirements.

The federal statute should require that all cards have an expiration date, and that the date can be no shorter than one year after activation. This information is vital for the consumer to have. Therefore, there should be significant consequences if the card does not include that disclosure. The federal statute should follow the laws enacted in Washington and Texas²¹⁸ and provide that if a seller fails to make that disclosure, the card is active indefinitely.

The federal statute should follow the pattern of state law by requiring other disclosures, but permitting the issuer to make them either on the card or on the packaging that comes with the card. Additionally, the issuer should be required to make the disclosures available at the point of sale.²¹⁹ Disclosures should include all charges, taxes, and fees.²²⁰ The seller should disclose the minimum charge per call, extra charges imposed for calls from pay phones, the billing decrement, the recharge policy, if any, and the refund policy.²²¹ The FTC should have the authority to regulate further in this area. For example, phone card issuers may impose new types of charges and conditions. The statute should define charges and conditions in general terms so the FTC can issue regulations under its disclosure authority to include these new costs.

Surcharges for international calls deserve special attention. Those making international calls have a special need for clear and ac-

cations Association, has commented regarding the special nature of phone card contracts, "handing over a package-a phone card or prepaid cellular-does not provide an opportunity for a formal contract." Segermark, *supra* note 100.

²¹⁸ 16 TEX. ADMIN. CODE § 26.34(f)(1)(B)(iv) (2006); WASH. ADMIN. CODE § 480-120-264(5)(a)(v).

²¹⁹ CAL. BUS. & PROF. CODE § 17538.9(b)(3) (West 2006).

²²⁰ Examples of fees include "monthly or other periodic fees, maintenance fees, per-call access fees, surcharges for calls made on pay telephones, or surcharges for the first minute or other period of use[.]" *Id.* § 17538.9(b)(3)(A).

²²¹ *Id.*; Illinois' and New York's requirements on disclosure of fees are similar. 815 ILL. COMP. STAT. 505/2QQ(d)(2) (2006); N.Y. PUB. SERV. LAW § 92-f(3) (McKinney 2006).

curate information. Therefore, it is important that the surcharges for international calls not be buried in with the other disclosures. Consequently, the statute should provide that if international calls are a significant focus of the issuer's marketing or if a substantial portion of the calls made on its cards are subject to surcharges for international calls, the issuer must make the disclosure of those surcharges in a prominent place on the card as well as on the packaging and at the point of sale. The statute should delegate to the FTC the responsibility to issue regulations further specifying the circumstances under which the special rules for international calls apply.

Consumers also need to know the balance remaining on their cards. Otherwise, when they have an important call to make, they may mistakenly believe they have more time than they actually have to make their call. The federal law should follow Texas' lead by requiring verbal disclosures at the beginning of each call informing the consumer of the minutes, billing increments, or dollars remaining on the card.²²² When the balance on the card is nearly exhausted, the issuer should be required to inform the consumer verbally that the time is about to expire.²²³

Furthermore, the federal statute should require several disclosures not mandated by state statutes. Sellers should have to inform consumers of their policy with regard to unilaterally changing the terms and conditions of providing service without prior notice to the consumer.²²⁴ Even better would be a provision requiring sellers to notify consumers beforehand of all proposed changes. Notification could be given verbally at the beginning of the consumer's call using the card.²²⁵ The consumer should be given the option of refusing to agree to the change. If the consumer refuses, she should be entitled to a refund of the unused value on the card. Sellers should be prohibited from charging a fee to obtain the refund.

Sellers should be required to disclose their policy on lost, stolen, unauthorized, and malfunctioning cards.²²⁶ In addition, the federal statute should require sellers to inform consumers whether they can redeem unused value on their card, and if they can, how it can be

²²² 16 TEX. ADMIN. CODE § 26.34(g)(1) (2006).

²²³ *Id.* § 26.34(g)(2).

²²⁴ *See* Budnitz & Saunders, *supra* note 81 at 172-73.

²²⁵ Notification should not create technical problems. Texas requires sellers to inform consumers verbally when their balances are nearly exhausted. 16 TEX. ADMIN. CODE § 26.34(g)(2) (2006).

²²⁶ *See supra* text accompanying notes 184-86 discussing the requirements for lost and stolen cards that the federal statute should impose.

redeemed and what charges may be imposed.

The statute should mandate the use of standard uniform terms that would be defined in the statute. This would enable consumers to comparison shop. Uniform terms would have uniform meanings, regardless of the state where the consumer purchased the card. In addition to requiring standard terms, certain terms should be prohibited to prevent the confusing and contradictory wording that many agreements contain.²²⁷ For example, some companies state there is no connection fee, leading consumers to believe there are no additional fees.²²⁸ This claim is misleading because instead of that fee they impose a fee at the conclusion of each call, called a “post-call” or “hang-up” fee. Sellers should be required to use a standard term that would apply to all fees imposed per call. Companies impose periodic charges for maintenance fees.²²⁹ The statute should require companies to use a standard term that would apply to all such maintenance fees. Companies should not be allowed to confuse consumers by using a variety of terms for such charges such as “administrative fee” or “service fee.” The statute should require a standard format for charges imposed for taxes. Standard uniform terms would benefit card issuers as well as consumers because the standardization would be easier for issuers to comply with than various state laws with differing requirements and definitions. The statute should authorize the FTC to develop a standard format for disclosures and model forms.

The federal statute should require that if the issuer uses a language other than English in advertising or promoting the card, or on the card or its packaging, then the required disclosures on the card or packaging must also be in that other language.²³⁰ If another language is used to provide dialing instructions for making calls or calling customer service, the disclosures required to be on the card or its packaging also must be in that other language.²³¹

Disclosure by card companies alone is not sufficient.²³² The federal statute should also require dispute resolution procedures and substantive rights and protections. The federal statute should ensure the effectiveness of customer service or else consumers will be at a

²²⁷ See *supra* text accompanying notes 46-56.

²²⁸ Marlowe, *supra* note 9, at 4.

²²⁹ *Id.* at 4-5.

²³⁰ CAL. BUS. & PROF. CODE §17538.9(b)(4) (West 2006).

²³¹ *Id.*

²³² Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POL'Y REV. 233, 264-65 (2002). “...disclosure statements...may not be able to aid most consumers in understanding the terms of their agreement.” *Id.* at 261.

severe disadvantage in learning essential information and seeking solutions for problems that arise. Issuers should be required to provide a toll-free telephone number for customer service, with that number clearly disclosed on the card itself. The issuer should be required to have an adequate number of trained, live operators available at least Monday through Friday, eight hours each day.²³³ The statute should require that the issuer record all calls made at other times, and that the recorded calls be returned no later than the end of the next business day.²³⁴ Consumers should have the right to file complaints when they call customer service,²³⁵ and the issuer should be required to investigate within ten business days, crediting the consumer's card or providing a refund if the consumer's complaint is justified.²³⁶ Consumers also need information when they call, and the issuer's customer service operators should have the capacity to provide information about rates, surcharges, fees, refunds, expiration dates, recharging cards, and the available balance.²³⁷

The federal statute should include rules for rounding charges up to the next minute and should prohibit excessive upwards rounding.²³⁸ Federal law should also prohibit the issuer from reducing the value of the card by more than the charges printed on the card or the packaging or information displayed at the point of sale.²³⁹ Moreover, the seller should be prohibited from imposing a fee if there is no connection made to the party dialed.

The federal statute should require the issuer to provide a refund when the issuer fails to provide service at the disclosed rates or

²³³ California and New York require live operators twenty-four hours a day and seven days a week. CAL. BUS. & PROF. CODE § 17538.9(b)(6)(A) (West 2006); N.Y. PUB. SERV. LAW § 92-f(4) (McKinney 2006).

²³⁴ See FLA. ADMIN. CODE ANN. r. § 25-24.920(4) (2006); MO. CODE REGS. ANN. tit. 4, § 240-32.160(5) (2006), 16 TEX. ADMIN. CODE § 26.34(i) (2000). Alabama requires that the number be manned 8 hours per day, five days per week. AL PUB. SERV. COMM'N Rule 18.1(5) (1997).

²³⁵ Consumers in New York and California can file complaints with customer service. CAL. BUS. & PROF. CODE § 17538.9(b)(6)(C) (West 2006); N.Y. PUB. SERV. LAW § 92-f(4) (McKinney 2006).

²³⁶ This scheme is similar to that in the Electronic Fund Transfers Act, 15 U.S.C. § 1693(f) (2006).

²³⁷ N.Y. PUB. SERV. LAW § 92-f (4) (McKinney 2006). New York also requires that the operator be able to provide information about the "terms and conditions of service and monthly service charges." *Id.* § 92-f(4)(iv).

²³⁸ FLA. ADMIN. CODE ANN. r. § 25-24.920(3)(c) (2006).

²³⁹ CAL. BUS. & PROF. CODE § 17538.9(b)(1) (2006); N.Y. PUB. SERV. LAW § 92-f (McKinney 2006).

charges more than disclosed or allowed.²⁴⁰ In addition, the consumer should receive a refund if the phone service fails to meet certain technical standards.²⁴¹ Refunds are warranted if service is suspended, terminated,²⁴² or unusable.²⁴³ Consumers should be entitled to a refund if the service does not work as represented, the required disclosures are not made,²⁴⁴ or the card is defective. Consumers should also be able to receive a refund of the unused balance on their card if they report their card as lost or stolen and the issuer has the capacity to block all future use of the card after receiving the consumer's notice.²⁴⁵

There may be other circumstances under which refunds should be required. Therefore, the statute should include more general standards as well. California and New York's models require a refund of at least the value remaining on the card if the service fails to operate in a "commercially reasonable manner."²⁴⁶ Other examples of general standards are provisions requiring a refund if the issuer fails to exercise ordinary care, acts in bad faith, or uses a contract that includes unconscionable terms.²⁴⁷

The federal statute should impose minimum performance standards. The seller should be required to have the capacity to accommodate a reasonably anticipated number of calls without con-

²⁴⁰ CAL. BUS. & PROF. CODE § 17538.9(b)(7) (2006); N.Y. PUB. SERV. LAW § 92-f (McKinney 2006).

²⁴¹ *Id.* The federal statute should allow the FTC to describe technical standards because the description requires a high level of technical expertise and specificity. Moreover, the standards may need to be adjusted as technology advances over time.

²⁴² AL. PUB. SERV. COMM'N Rule T-18.1(4)(1997).

²⁴³ FLA. ADMIN. CODE ANN. r. § 25-24.925 (1)(a) (2006). *See also* MO. CODE REGS. ANN. tit. 4, § 240-32.170(6) (2006) (providing that a company must refund the unused value remaining on cards when the "company is no longer able to provide service").

²⁴⁴ ALASKA ADMIN. CODE tit. 3, § 52.3771(e) (2006).

²⁴⁵ FLA. ADMIN. CODE ANN. r. § 25-24.925(2) (2006) (permitting, but not requiring, a refund for lost or stolen cards).

²⁴⁶ CAL. BUS. & PROF. CODE § 17538.9(b)(7) (West 2006); N.Y. PUB. SERV. LAW § 92-f (McKinney 2006).

²⁴⁷ Commercial reasonableness, failure to exercise ordinary care, good faith, and unconscionability are all standards included in the Uniform Commercial Code. Consequently, including them in the proposed statute is not a novel approach. *See* U.C.C. §§ 3-103(a)(6) & (9) (2002); U.C.C. § 2-302 (2003); U.C.C. § 9-610(b) (2000).

sumers encountering a busy signal or unreasonable delay.²⁴⁸ The FTC should set requirements for what percentage of calls must be completed and the accuracy of the company's calculation of the conversation time.²⁴⁹

The federal statute should also include a guaranty stating that both the card and the service provided meet minimum standards. Accordingly, it should provide that there is an implied warranty of merchantability in every phone card transaction. This is the law under the UCC with regard to the sale of goods.²⁵⁰ Unlike the UCC, however, the issuer should not be allowed to disclaim that implied warranty.²⁵¹

The federal statute should establish a maximum cap on a consumer's liability as long as the card issuer has the ability to block access so the thief cannot continue to use the card.²⁵² If the issuer does not have that ability, the law should require a prominent disclosure on the card or its packaging that the purchaser will lose the entire balance on the card if it is lost, stolen, or used in an unauthorized fashion, if that is the issuer's policy.

Consumers may lose their PINs rendering the card useless and resulting in the loss to the consumer of the value remaining on the card.²⁵³ A seller should be required to supply a new PIN if the consumer notifies the seller and the seller has the ability to block access to anyone using the lost PIN. If the seller lacks the ability to block access and does not want to provide consumers any relief, the federal statute should require the seller to clearly warn consumers either on the card or its packaging that they have no protection if the PIN is lost.

Additionally, the statute should require sellers to replace defective cards.²⁵⁴ Consumers will lose the entire balance on the card if

²⁴⁸ CAL. BUS. & PROF. CODE § 17538.9 (b)(7) (West 2006).

²⁴⁹ FLA. ADMIN. CODE ANN. r. § 25-24.930 (repealed 2005).

²⁵⁰ U.C.C. § 2-314 (2003).

²⁵¹ *Id.* § 2-316 (2003) (allowing sellers to disclaim implied warranties). *See, e.g.,* MD. CODE ANN., COM. LAW § 2-316.1 (West 2006) (illustrating that some states prohibit sellers from disclaiming implied warranties in consumer transactions).

²⁵² *See* Budnitz & Saunders, *supra* note 81, at 7.7.1.

²⁵³ David Wood, *Tips on Using Prepaid Phone Cards*, MILITARY MONEY MAG., available at <http://www.militarymoney.com/lifestyle/1065704890> (last visited Oct. 5, 2006).

²⁵⁴ Examples of defects include access numbers or PINs that do not work and other defects making it impossible for the card to operate as it should. A lost PIN

the card issuer refuses to replace it. The law should prohibit sellers from charging more than a reasonable fee for a replacement.²⁵⁵ If sellers can charge exorbitant replacement fees, it will be economically inadvisable for the consumer to order a replacement.

Consumers need meaningful remedies otherwise they have no means for recovering the losses they incur as a result of violations of the law. The federal statute should include the remedies contained in federal consumer protection laws, providing for actual damages, statutory damages, costs and attorney's fees.²⁵⁶ Class actions should be expressly permitted, or else litigation will not be feasible, given the small amount of each individual's damages. Predispute mandatory arbitration should be prohibited.²⁵⁷

The recommendations made thus far should be in a federal statute or accompanying FTC regulations. They involve national problems that are best dealt with on a uniform nationwide basis both to ensure that consumers can enjoy a basic level of protection wherever they live and to lower compliance costs for the industry. If Congress fails to enact a law, however, states should pass their own statutes, using the above as a model, and delegating regulatory authority to the appropriate state agency.

Some issues are best dealt with on a state basis rather than through a federal law. Examples of this include the licensing and registration of companies. Some states require this already, and the rest should be encouraged to consider it. States also should require companies to post a bond so consumers will have a fund from which they can be compensated in case a company goes out of business. Some states require phone card companies to file tariffs listing all of their rates and fees, with a state agency empowered to reject those

may never be found. In that situation the consumer has paid money for the card and the seller never has to provide any more value. The card issuer may be required to transfer those funds to the state under abandoned property or escheat laws. Even where those laws apply to prepaid phone balances, the seller has the use of those funds until they are paid to the state. *See Luna, supra* note 18; *Big Retailers Agree to Replace Gift Cards, supra*, note 204.

²⁵⁵ The statute should delegate to the FTC the authority to study the actual costs to sellers of replacing cards in order to establish more specific guidelines for what would constitute a reasonable fee.

²⁵⁶ *E.g.*, Electronic Fund Transfers Act, 15 U.S.C. § 1693 (2006).

²⁵⁷ A comprehensive critique of mandatory predispute arbitration in phone card contracts is beyond the scope of this article. *See* Symposium, *Mandatory Arbitration*, 67 LAW & CONTEMP. PROBS. 1 (2004) (showing that mandatory arbitration agreements are a substantial barrier to consumers' ability to obtain meaningful relief).

rates.²⁵⁸ We believe it best to leave that decision to the states rather than establish a federal bureaucracy to oversee rate regulation for all sellers. While lawmakers generally are reluctant to regulate fees, regulation of phone card fees is warranted because of the low income and vulnerable status of many of the consumers who are specifically targeted by the industry. Consequently, states should consider enacting laws prohibiting rates above a certain amount, as states already do for consumer credit. There is a great deal of diversity in the demographic characteristics of various states. Individual states may find it necessary to enact special protections for vulnerable groups within their states, such as immigrants.

Finally, federal and state laws governing phone cards should prohibit waiver of the requirements mandated in the laws. Strong consumer protection laws do not benefit consumers if sellers can enforce contractual provisions by which consumers agree to waive provisions in those laws intended to benefit and protect them.

XII. Conclusion

Empirical studies indicate that consumers have difficulty obtaining necessary information about prepaid telephone cards before purchase. Information is often unavailable, misleading, and confusing. There is no federal regulation of prepaid phone cards. Although numerous states have statutes or administrative regulations, they vary widely and many states have no laws regulating phone cards. Both card issuers and consumers could be better served with federal legislation.

This article presents a case for federal legislation and a proposed model act which would draw upon the best of current state regulations. The Federal Trade Commission is the suggested avenue for administrative agency regulations and enforcement of the proposed legislation. The federal legislation also must provide a private right of action for consumers, providing them with meaningful remedies when they are injured due to a company's failure to comply with the law. However, a few issues should be left to the states' discretion. If Congress fails to enact legislation, the states should pass the model act.

²⁵⁸ 16 TEX. ADMIN. CODE § 26.34(e)(4) (2000) (requiring that prepaid calling card service companies register with the Public Service Commission).