

**PREPARED STATEMENT OF
THE FEDERAL TRADE COMMISSION**

on

PREPAID CALLING CARDS

Before the

COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION

UNITED STATES SENATE

**WASHINGTON, D.C.
September 10, 2008**

¹The written statement presents the views of the Federal Trade Commission. Oral statements and responses to questions reflect the views of the speaker and do not necessarily

of prepaid calling cards. It also discusses the FTC's consumer education and outreach efforts. Additionally, it offers comments on S. 2998, the "Prepaid Calling Card Consumer Protection Act of 2008," introduced by Senators Bill Nelson, Olympia Snowe, John Kerry, and Mel Martinez. Finally, the Commission reiterates its support for the provision of the FTC reauthorization bill that would amend the FTC Act to repeal the exemption for common carriers subject to the Communications Act. Repealing the exemption for telecommunications carriers would ensure that the Commission can bring law enforcement actions against all participants in the prepaid calling card industry that are engaging in deceptive and unfair practices, including those companies that provide the underlying telecommunications services for these cards.

II. Background

Calling card providers market their cards for a variety of uses. Some cards are marketed primarily for use by consumers making calls within the United States. Such cards usually offer consumers the ability to make domestic long distance calls for pennies per minute. Other cards are marketed to U.S. consumers who want to call the United States when they are traveling or working in other countries. Indeed, many such cards are marketed to members of the United States armed forces serving around the world. In addition, a substantial number of prepaid calling cards are sold to recent immigrants to the United States who depend on calling cards to stay in touch with family and friends abroad.² Such calling cards, which typically retail for

See Susan Sachs, *Immigrants See Path to Riches in Phone Cards*, N.Y. TIMES, Aug. 11, 2002, available at <http://query.nytimes.com/gst/fullpage.html?res=9800E7D6123AF932A2575BC0A9649C8B63&sec=&spon=&pagewanted=2>; *Talk Isn't So Cheap on a Phone Card*, BUSINESS WEEK, July 23, 2007, available at http://www.businessweek.com/magazine/content/07_30/b4043079.htm; Mark E. Budnitz, Martina Rojo & Julia Marlowe, *Deceptive Claims for Prepaid Telephone Cards and the Need for Regulation*, 19 LOYOLA CONSUMER L. REV. 1 (2006).

between \$2 to \$10 each, are generally sold in small retail outlets, including grocery and convenience stores, gasoline stations, and newsstands.

To advertise prepaid calling cards directed to consumers making international calls from the U.S., companies distribute eye-catching posters that are displayed on the walls and windows of the stores where such cards are sold. One hallmark of such posters is bold claims, made in large, colorful type, about the number of calling minutes the advertised cards provide for calls to particular countries. In stark contrast to the claims about available calling minutes that dominate the posters, the bottom of the posters generally contains small print disclaimers about a wide variety of fees and surcharges that reduce the value of the cards. The disclaimers are frequently in type so small as to be nearly illegible and in language so vague as to be effectively incomprehensible.³

Consumers typically use their prepaid calling cards as follows: the consumer dials an

³For example, in *FTC v. Alternatel, Inc., G.F.G. Enterprises LLC, also d/b/a Mystic Prepaid, Voice Prepaid, Inc., Voice Distributors, Inc., Telecom Express, Inc., Lucas Friedlaender, Moses Greenfield, Nickolas Gulakos, and Frank Wendorff*, 08-21433-CIV-Jordan/McAliley (S.D. Fla.), the FTC has alleged in its complaint that: “in numerous instances defendants’ posters contain vague disclosures about fees in tiny font on the bottom of the poster, stating in relevant part:

by using this card you agree to the following: Prompted minutes are before applicable charges and fees, application of surcharges and fees have an effect of reducing total minutes on cards. One or all of the following may apply: 1) A weekly maintenance fee ranging between .49 and .79. 2) A hang-up fee between .05 and \$1 depending upon length and destination of the call. 3) A destination surcharge of between 0% and 100%. – minutes and/or seconds are rounded to multiple minute increments. – International calls made to cellular phones are billed at higher rates. – Toll free access numbers are subject to an additional fee of up to 4 cents per minute. – Prices are subject to change without notice. – This card has no cash value. – Card expires 3 months after first use or 12 months after activation.”

“access number” printed on the back of the card. A recorded message then prompts the consumer to enter the card’s authorization code or Personal Identification Number (“PIN”), which is printed on the card. Next, the consumer usually hears an announcement of the monetary value of the card. The consumer then enters the phone number he or she is trying to reach and hears an automated “voice prompt” announcing the number of minutes of time ostensibly available on the card.

As discussed in more detail below, the FTC, our state law discuaD T1(t4uishT*.c7le)12(,gue, Mnd,]TJ3-

⁴Representatives from the following Offices of Attorneys General are members of the task force: Alabama, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Maine, Massachusetts, Minnesota, Missouri, Montana, New Mexico, Nevada, New

Currently, the Commission is litigating two actions in federal district court, alleging that the defendants deceptively marketed their prepaid calling cards. In addition, as discussed below, the Attorneys General for the states of Florida and Texas recently have taken action against prepaid calling card companies for their allegedly deceptive practices.

A. FTC Enforcement Actions

Under Section 5 of the FTC Act, the FTC has authority to bring cases against companies and individuals for engaging in deceptive or unfair acts or practices in or affecting commerce.⁵ Since the 1990s, the FTC has used this power to bring enforcement actions against entities for deceptively selling prepaid calling cards. The Commission brought its first two prepaid calling card cases against companies that the FTC alleged were deceptively marketing prepaid calling cards by, among other things, misrepresenting the per-minute rates consumers would be charged when using the cards and by failing to clearly and conspicuously disclose connection and maintenance fees associated with the cards.⁶ Since then, the FTC has brought several cases alleging that telemarketers deceptively marketed calling cards to consumers and charged

Hampshire, New Jersey, New York, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Virginia, Washington, Wisconsin. In addition, the New York State Consumer Protection Board and the New York City Department of Consumer Affairs have participated in the task force.

⁵15 U.S.C. § 45(a)(2).

⁶*FTC v. PT-1 Comm'cns, Inc.*, 99-CIV-1432 (S.D.N.Y.) (Stip. Final Order filed Feb. 25, 1999) (order requiring monetary relief and barring defendants from misrepresenting the value of its prepaid calling cards and from failing to clearly and prominently disclose fees and charges); *FTC v. Trans-Asian Comm'cns, Inc.*, 97-CIV-5764 (S.D.N.Y.) (Stip. Final Order filed Mar. 17, 1998) (order requiring \$1 million performance bond before defendants can advertise or sell prepaid calling cards and barring future material misrepresentations about prepaid calling cards).

¹⁰The results of the FTC testing of the defendants' cards in the *Clifton Telecard Alliance* and the *Alternatel* cases are consistent with the testing results of the Hispanic Institute, a non-profit organization that has issued a report on its testing of a wide variety of prepaid calling cards. The Hispanic Institute reports that, on average, the cards it tested delivered only 60% of the minutes promised in voice prompts. See <http://www.thehispanicinstitute.net/research/callingcard/qa> (visited June 18, 2008). They are also consistent with testing results that have been offered in private litigation. See *IDT Telecom, Inc. v. CVT Prepaid Solutions, Inc., et al.*, Civil Action No. 07-1076 (D.N.J.) (Pls. Mem. In Suppl. of Their Order to Show Cause Why a Prelim. Inj. Should Not Issue, at 6-10; Ex. 1 to Suppl. Aff. of Gabi Schechter, dated Mar. 26, 2007) (alleging the defendants' calling cards delivered on average only 60% of prompted minutes); *IDT Telecom, Inc. v. Voice Distributors, Inc., d/b/a Voice Prepaid, et al.*, Civil Action No. 07-2465 (Mass. Sup. Ct., Middlesex Cty.) (Compl. ¶ 16) (alleging that the defendants' calling cards delivered on average only 65% of prompted minutes); *IDT Telecom, Inc. v. Diamond Phone Card, Inc., et al.*, Index No. 3682-08

to the Communications Act. The FTC has opposed defendants' motions, and is confident that it will win on the merits. As final relief in both cases, the FTC seeks a permanent injunction and consumer redress and/or disgorgement of ill-gotten gains.

B. State Law Enforcement Actions

Two states recently brought law enforcement actions against a number of prepaid calling card companies. Over the last few months, the Florida Attorney General has announced that he has entered into Assurances of Voluntary Compliance ("AVC") with eleven prepaid calling card companies doing business in Florida.¹¹ These settlements are the culmination of a broad investigation into the prepaid calling card industry launched by the Florida Attorney General in July of 2007. Notably, while the FTC has brought its lawsuits solely against distributors of prepaid calling cards, the Florida Attorney General entered into AVCs with eleven companies that include both distributors and telecommunications service providers for prepaid calling cards.

On May 23, 2008, the Texas Attorney General filed a lawsuit against Next-G Communication, Inc., a telecommunications service provider that produces, sells and distributes

¹¹See *McCollum Announces Prepaid Calling Card Settlements, Industry-Wide Reform* (June 11, 2008) available at <http://myfloridalegal.com/newsrel.nsf/newsreleases/79C6666DB24608D785257465004EC901> (visited on August 27, 2008) (announcing settlements with IDT America, Inc.; Union Telecom Alliance; Total Call International, Inc.; Blackstone Calling Card, Inc.; CVT Prepaid Solutions, Inc.; Dollar Phone Enterprise, Inc.; STi Prepaid, LLC; Alternatel, Inc; and Cristel Telecommunications, LLC); *Prepaid Calling Company Reaches Settlement with Attorney General* (July 2, 2008) available at <http://myfloridalegal.com/newsrel.nsf/newsreleases/1439BD5308D470588525747A006423B8> (visited on August 27, 2008) (announcing a settlement with Touch-Tel Partners USA, LLC); *Attorney General Reaches Settlement with 11th Prepaid Calling Card Company* (August 21, 2008) available at <http://myfloridalegal.com/newsrel.nsf/newsreleases/C410C546EB409C93852574AC006C9499> (visited on August 27, 2008) (announcing settlement with Cinco Telecom Corp. d/b/a Orbitel)

prepaid calling cards.¹² The Texas lawsuit alleges that Next-G Communication has marketed and sold prepaid calling cards throughout Texas that fail to deliver the number of minutes it advertises to customers and that the defendant has failed to disclose fees and charges associated

¹²*State of Texas v. Next-G Commnc'n, Inc., Taj Khwaja*, 2008CI08149 (Bexar County, TX) (Pet. filed May 23, 2008).

¹³*See Attorney General Abbott Takes Legal Action Against Prepaid Calling Card Company* (May 23, 2008) available at <http://www.oag.state.tx.us/oagNews/release.php?id=2479> (visited on August 27, 2008).

¹⁴*See Buying Time: The Facts About Pre-Paid Phone Cards* (2008) available at <http://www.ftc.gov/bcp/edu/pubs/consumer/products/pro04.pdf> (visited on August 27, 2008).

the fees and charges that reduce the value of the calling cards. The FTC also wants consumers to know that they can and should complain to the FTC if they do not get what they pay for.

V. The Proposed Legislation

As described above, the FTC Act's prohibitions on deceptive and unfair practices provide the Commission with a powerful tool to bring enforcement actions against the distributors of prepaid calling cards. Senate Bill 2998, the proposed "Prepaid Calling Card Consumer Protection Act," is directed at the conduct of prepaid calling card service providers (carriers) as well as distributors, and therefore would implicitly give the FTC jurisdiction over common carriers engaged in the deceptive practices prohibited by the proposed legislation. Consumers would benefit greatly from legislation giving the FTC jurisdiction over such practices by telecommunications carriers. The legislation also would authorize the FTC to seek civil penalties for violations of the Act or of the rules issued by the FTC pursuant to the Act, thus adding an important remedy to those already available to the Commission.

Generally, S. 2998 requires the FTC to promulgate a rule requiring that, among other things, prepaid calling card providers and distributors provide clear and conspicuous disclosures of the number of minutes provided by the calling cards, the amount and frequency of all fees assessed for use of the calling cards, and the expiration date of the cards. The bill also prohibits prepaid calling card providers and distributors from selling or distributing calling cards that do not provide the advertised number of calling minutes or from assessing inadequately disclosed fees. The bill further provides for the FTC to bring suit alleging violations of the Prepaid Calling Card Consumer Protection Act as if they were violations of an FTC rule, thus enabling the agency to seek civil penalties for violation of the Act and the FTC's rule promulgated pursuant to the Act.

¹⁵The bill does not have a parallel knowledge requirement for prepaid calling card service providers.

¹⁶Indeed, under general consumer protection principles and traditional jurisprudence under Section 5 of the FTC Act, 15 U.S.C. § 45, the Commission need not show knowledge or intent in order to stop an entity from engaging in unfair or deceptive practices. Notably,

business practices to prepaid wireless handsets and refill cards, and thereby avoid the mandates of the proposed law.¹⁷

To enable the Commission to address problems with deceptive conduct involving prepaid calling cards more effectively, the Committee might also consider giving the Commission authority to bring actions seeking civil penalties in its own right against prepaid calling card providers and distributors rather than through the Department of Justice. Giving the FTC authority to bring its own civil penalties cases in this area would help ensure that the Commission does not have to forego quick relief in order to seek civil penalties.

The Commission recognizes that the agency and the Committee share the same goal: stopping unscrupulous calling card companies from defrauding vulnerable consumers. The Commission looks forward to working with the Committee regarding the language of the legislation as the Committee moves forward.

VI. The Common Carrier Exemption

On several occasions, the Commission has testified in favor of the repeal of the common carrier exemption.¹⁸ The Commission continues to endorse its repeal, and thanks the Committee

¹⁷Some participants in the prepaid calling card industry are beginning to offer prepaid wireless services. As the cost of providing cellular phones and calling minutes continues to decrease, the incentive to move consumers to prepaid wireless accounts from more traditional prepaid calling cards has increased.

¹⁸See *Prepared Statement of the Federal Trade Commission*, Before the Subcommittee on Interstate Commerce, Trade, and Tourism Committee on Commerce, Science and Transportation United States Senate (April 8, 2008), available at <http://www.ftc.gov/os/testimony/P034101reauth.pdf>; *Prepared Statement of the Federal Trade Commission*, Before the Subcommittee on Interstate Commerce, Trade, and Tourism Committee on Commerce, Science and Transportation United States Senate (Sept. 12, 2007), available at <http://www.ftc.gov/os/testimony/070912reauthorizationtestimony.pdf>; *Prepared Statement of the Federal Trade Commission On FTC Jurisdiction Over Broadband Internet Access Services*, Before the Committee on the Judiciary, United States Senate (Jun. 14, 2006), available at

for its continued support for this measure. The FTC Act exempts common carriers subject to the Communications Act from its prohibitions on unfair and deceptive acts or practices and unfair methods of competition. This exemption originated in an era when telecommunications services were provided by highly-regulated monopolies. The Commission believes that the exemption is now outdated. In the current marketplace, firms are expected to compete in providing telecommunications services. Congress and the FCC have dismantled much of the economic regulatory apparatus formerly applicable to the industry. Removing the exemption from the

<http://www.ftc.gov/opa/2006/06/broadband.shtm>; *The Reauthorization of the Federal Trade Commission: Positioning the Commission for the Twenty-First Century: Hearing Before the Subcomm. on Commerce, Trade and Consumer Protection of the H. Comm. on Energy and Commerce*, 108th Cong. (2003) (“*FTC 2003 Reauthorization Hearing*”) (statement of the FTC), available at <http://www.ftc.gov/os/2003/06/030611reauthhr.htm>; see also *FTC 2003 Reauthorization Hearing* (statement of Thomas B. Leary, FTC Commissioner), available at <http://www.ftc.gov/os/2003/06/030611learyhr.htm>; *FTC Reauthorization Hearing: Before the Subcomm. on Consumer Affairs, Foreign Commerce and Tourism of the S. Comm. on Commerce, Science and Transportation*, 107th Cong. (2002) (statement of Sheila F. Anthony, FTC Commissioner), available at <http://www.ftc.gov/os/2002/07/sfareauthtest.htm>.

additional litigation costs on the FTC. For example, as noted above, in both the *Clifton Telecard Alliance* and *Alternatel* cases, which the FTC has brought against distributors of prepaid calling cards, the defendants have moved to dismiss the FTC's cases on the grounds that the FTC has not sued and cannot sue the underlying carriers, which defendants allege to be necessary parties. While the Commission is confident that it will prevail in its opposition to these motions, the burden of having to respond to such motions is not insubstantial.

The American public will benefit greatly from S. 2998's grant to the FTC of jurisdiction over common carriers in the prepaid calling card arena. The FTC respectfully continues to recommend that, rather than take a piecemeal approach to providing the FTC with jurisdiction in this important area of commerce, Congress repeal altogether the FTC Act exemption for common carriers subject to the Communications Act. The FTC has extensive expertise with such areas as advertising, marketing, billing, and collection, areas in which significant problems have emerged in the telecommunications industry.¹⁹ In addition, the FTC has powerful procedural and remedial tools that could be used effectively to address developing problems in the telecommunications industry if the FTC were authorized to reach them.

VII. Conclusion

The Commission will continue its aggressive law enforcement and consumer outreach

¹⁹For example, the FTC has brought numerous cases involving the cramming of unauthorized charges onto consumers phone bills. *See, e.g., FTC v. Verity Int'l Ltd*, 335 F. Supp. 2d 479 (S.D.N.Y. 2004), *aff'd in part, rev'd in part*, 443 F.3d 48 (2d Cir. 2006), *cert. denied*, 127 S. Ct. 1868 (2007); *FTC v. Audiotex Connection, Inc.*, C-97 0726 (DRH) (E.D.N.Y. 1997); *FTC v. Int'l Telemidia Assocs., Inc.*, 1-98-CV-1925 (N.D. Ga., 1998); *FTC v. Sheinkin*, 2-00-363618 (D.S.C., 2000); *FTC v. Mercury Marketing of Delaware, Inc.*, 00-CV-3281 (E.D. Pa. 2000); *FTC v. Epixtar Corp.*, 03-CV-8511 (DAB) (S.D.N.Y. 2003); *FTC v. Nationwide Connections, Inc.*, 06-80180-CIV-Ryskamp/Vitunack (S.D. Fla. 2006); *FTC v. Webservice Media, LLC*, Civ. No. H-06-1980 (S.D. Tex. 2006).

and education programs in the prepaid calling card arena. The Commission thanks this Committee for focusing attention on this important issue and for the opportunity to discuss its law enforcement program.