

Update: FTC's "Red Flags" Rule

Background

FTC rule published in November 2007 – What does that have to do with us?

The federal Identity Theft "Red Flags" Rule caught many health care providers by surprise. Health care providers are not ordinarily subject to regulation by the Federal Trade Commission (FTC) and did not expect to be included in rules associated with a federal law that mostly addresses banking and credit transactions. However, the FTC determined that the Red Flags Rule did indeed apply to health care providers who permit clients to defer payment for services.

After studying the rule closely, School of Government faculty and NC Division of Public Health staff concluded that the rule was likely to apply to North Carolina local health departments. Accordingly, we recommended that local health departments develop the identity theft prevention plans required by the rule. The SOG published a bulletin explaining the applicability of the rule to local health departments.¹ Also, a group of local health directors worked with DPH to develop a template for an identity theft prevention plan, which was distributed at the 2009 Health Directors' Legal Conference.

Rule enforcement delayed ... and delayed ... and delayed ...

The Red Flags Rule was supposed to take effect in late 2008, but the FTC delayed enforcement of the rule five times. Initially, the delays were to allow entities who were covered by the rule more time to come into compliance (especially entities that had been surprised by the conclusion the rule applied to them). Later, the FTC announced that it was granting further delays to permit Congress to consider legislation that would clarify to whom the rule applied. Meanwhile, the FTC was also defending lawsuits brought by professional groups who did not believe the rule should apply to their professions. The leading suit was brought by the American Bar Association, which argued that the rule should not apply to attorneys. The American Medical Association brought a similar suit on behalf of health care providers.

Red Flags clarification?

In December 2010, Congress enacted the Red Flag Program Clarification Act (P.L. 111-319), which amended the definition of "creditor" to exclude entities "that advance funds on behalf of a person for expenses incidental to a service provided" to that person. Some commentators quickly concluded that this meant health care providers would not be subject to the rule after all, but

¹ Jill Moore, *The Identity Theft "Red Flag" Rules and North Carolina Local Health Departments*, Health Law Bulletin No. 89 (November 2008), available at <http://www.sog.unc.edu/pubs/electronicversions/pdfs/hlb89.pdf>.

others said “not so fast.” I was in the latter group. Although there were good reasons to believe that many (perhaps most) health care providers would no longer be covered by the rule, the Clarification Act was not as clear as it could have been. First, the revised definition of “creditor” did not explicitly establish exemptions for particular professions,² and it was not clear how the FTC might interpret the exclusion for entities that advance funds for expenses that are incidental to service provision. Second, the Clarification Act afforded the FTC the opportunity to pull at least some health care providers back into coverage through additional rule-making. Because of these ambiguities, on December 14 I sent an email via the phleaders listserv recommending that health departments hold onto their Identity Theft Prevention plans while awaiting further guidance from the FTC. I also optimistically predicted that the FTC would clarify who was covered by the rule quickly, as enforcement was scheduled to begin on January 1, 2011. I was wrong—the FTC has yet to issue clarification. But meanwhile, the courts have acted.

Significant New Development: *American Bar Association v. Federal Trade Commission*³

In August 2009, the American Bar Association filed a lawsuit in federal court challenging the Red Flags Rule. The ABA won its case—the district court for the District of Columbia enjoined the FTC from enforcing the rule against attorneys engaged in the practice of law—and the FTC appealed. The D.C. Circuit Court of Appeals heard arguments in the case in November 2010, one month before Congress adopted the Red Flag Program Clarification Act.

On March 4, 2011, the D.C. Circuit Court of Appeals concluded that the Clarification Act had rendered the lawsuit moot and ordered the case dismissed. The court compared the FTC’s interpretation of the original definition of “creditor” with the Clarification Act’s amended definition and concluded:

[T]he Clarification Act makes it plain that the granting of a right to ‘purchase property or services and defer payment therefore’ is no longer enough to make a person or firm subject to the FTC’s Red Flags Rule – there must now be an explicit advancement of *funds*. In other words, the FTC’s assertion that the term ‘creditor,’ as used in the Red Flags Rule and the FACT Act, includes ‘all entities that regularly permit deferred payments for goods or services,’ including professionals ‘such as lawyers or health care providers, who bill their clients after services are rendered,’ ... is no longer viable.

² Earlier, a bill had been introduced that would have explicitly excepted certain health care providers, but Congress never acted on that bill (HR 3763).

³ --- F.3d ---, 2011 WL 744659 (D.C. Cir. Mar. 04, 2011).

The court also acknowledged the legislative history of the Clarification Act and specifically quoted legislators who had stated that the purpose of the Act was to clarify that lawyers, dentists, doctors, and certain other professional service providers should not be covered by the Red Flags Rule solely because they allow clients to defer payment for services.

As a practical matter, the Court's conclusion that the case had been rendered moot by the Clarification Act probably means the FTC is not going to attempt to enforce the Red Flags Rule *as presently written* against attorneys.⁴ However, the court noted that the Clarification Act left open the possibility that the FTC could "promulgate *new* rules pursuant to which the agency may seek to regulate lawyers and law firms." But a court cannot issue an opinion about the validity of rules that do not yet exist.

What Does this Mean for Health Care Providers?

Three days after the D.C. Circuit issued its decision in the ABA case, the American Medical Association dropped its lawsuit, based on its belief that the court would apply the same reasoning to conclude that health care providers are not subject to the Red Flags rule as presently written. The FTC has not formally commented on the matter, but a general consensus has developed among health care attorneys and provider associations that the current Red Flags rule does not apply to health care providers who were previously considered covered only because they allowed clients to defer payment for services.⁵

However, as the D.C. Circuit noted, at some time in the future the FTC could issue new rules that reach health care providers. I will keep watching this issue and will let you know if that happens.

Jill Moore, JD, MPH
UNC School of Government
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⁴ Unless they otherwise meet the definition of "creditor"—see footnote 5.

⁵ Under the new definition of "creditor," the Red Flags rule still applies to an entity that (1) obtains or uses consumer reports in connection with credit transactions, (2) furnishes information to consumer reporting agencies, or (3) advances funds to a person that the person is obliged to repay (other than funds advanced for expenses incidental to a service the entity provides to the person).