

## Lawyers Spared From Red Flags Rule

Lawyers *are* different. That's what the American Bar Association (ABA), several states and local bar associations advocated in their fight against the Federal Trade Commission's (FTC) attempt to apply the Red Flags Rule to lawyers. Last week, the U.S. Senate unanimously approved legislation that would exempt lawyers and certain other professionals from the rule.

### "Creditors" Under The Red Flags Rule

The Red Flags Rule implemented the Fair and Accurate Transactions Act of 2003 (FACT Act) by requiring certain businesses and organizations to develop and implement a written identity theft prevention and detection program to detect warning signs or 'red flags' (i.e., patterns, practices or specific activities) that could indicate identity theft. The rule broadly applied to "creditors" defined under the FACT Act to include any person that sells a product or service for which the consumer can defer payment. This definition was widely viewed as too far reaching, requiring businesses across the board to undertake onerous measures to combat identity theft in industries that pose minimal risk to consumers.

### ABA Sues FTC

A number of professional organizations, including the ABA, sued the FTC for attempting to regulate their professions. The FTC took the position that professionals were "creditors" when they allowed customers to pay for services after they were performed, thereby requiring compliance with the Red Flags Rule. The federal district court ruled in favor of the ABA, holding that lawyers were not the population Congress intended to target to fight identity theft in the credit industry, but rather entities involved in banking, lending, or financial related business with account holders or customers. The FTC appealed its ruling to the U.S. Court of Appeals for the D.C. Circuit.

### Congress Redefines "Creditors"

Urged by the FTC, Congress recently introduced new legislation called the Red Flag Program Clarification Act of 2010 to narrow the scope of the FACT Act in order to identify and limit the type of "creditor" that must be covered.

Under the new law, only a creditor that:

1. regularly and in the ordinary course of its business obtains or uses consumer reports in connection with a credit transaction;
2. furnishes information to consumer reporting agencies in connection with a credit transaction;
- or
3. advances funds

would be required to develop and implement an identity theft prevention and detection program.

The legislation explains that an advance of funds does not include a creditor's payment in advance for fees or services that are incidental to the creditor's ability to provide another service that a person initiated or requested, such as advance payment of expert witness fees by a lawyer to support the representation

of a client. (See *Colloquy in Support of Legislation Clarifying the Definition of Creditor under the FTC Red Flags Rule*).

### **We're Lawyers Not "Creditors"**

The new law makes clear that lawyers, accountants, physicians and other health care providers will no longer be classified as "creditors" for purposes of the Red Flags Rule simply because they do not receive payment in full from consumers at the time they provide their services, given that they do not offer or maintain accounts that pose a reasonably foreseeable risk of identity theft.

### **Final Touches**

The ABA currently awaits a ruling from the D.C. Circuit to affirm the district court's ruling to exempt lawyers from the FACT Act. The ABA expects that suit to be dismissed after a vote on the new bill by the House of Representatives, where it presently faces no opposition.

If you have questions regarding this Alert, please contact the co-chair of Moses & Singer's [Legal Ethics & Law Firm Practice](#), **Devika Kewalramani** at 212.554.7832 or [dkewalramani@mosessinger.com](mailto:dkewalramani@mosessinger.com).

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