

The Red Flags Rule: controversy over application to physicians

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LEGAL CHALLENGES UPDATE

Our article in the June issue of JNIS described the legal challenges against the Federal Trade Commission's Red Flags Rule, which requires "creditors" to adopt programs to protect their customers from identity theft. Specifically, on November 29, 2009, the US District Court for the District of Columbia ruled that the FTC had improperly applied the Red Flags Rule to lawyers in a case brought by the American Bar Association. The FTC appealed the decision. While the appeal was pending the President signed into law the Red Flag Program Clarification Act of 2011 (the "Clarification Act").ⁱ

On March 4, 2011, the US Court of Appeals for the District of Columbia dismissed the ABA case as moot based on the passage of the Clarification Act.ⁱⁱ The US Court of Appeals found that the statute changed the definition of "creditor" in a way that vitiated the basis for the FTC's application of the Red Flags Rule to lawyers. Specifically, the Act defeated the FTC's conclusion that the definition of creditor includes someone who defers payment for services rendered. The US Court of Appeals stated:

Most importantly, at least with respect to the matters in dispute in this case, the 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 healthcare providers, who bill their clients after services are rendered," Extended Enforcement Policy at 1 n.3, J.A. 76, is no longer viable.ⁱⁱⁱ

However, the US Court of Appeals did acknowledge that it is possible that the FTC could modify its rule to change the basis for applying the law to lawyers (or physicians). The FTC could do this by taking the position that lawyers (and physicians) are covered to the extent that they do advance funds to their clients (or patients).

Further, the FTC could invoke clause (C) of the Clarification Act to cover lawyers (and physicians). Clause (C) gives the FTC broad discretion to define other entities as creditors if the FTC determines that "such creditor offers or maintains accounts that are subject to a reasonably foreseeable risk of identity theft."

The Court of Appeals refused to speculate on whether the Clarification Act

definition of creditor could be applied to lawyers (or physician), finding that this issue was not before it because it was not part of the regulation and had not been raised in the complaint or briefs. The decision in the lower court was thus vacated in order to allow the parties to refile if the FTC issues regulations that cover lawyers (and physicians) under the Clarification Act's definition of creditor.

Relying on the ABA case, the American Medical Association, as well as the coalition of 26 medical specialty societies represented by our firm, submitted a joint stipulation in April to dismiss the parallel AMA case (described in our article) as moot for the same reasons applied in the ABA case.

CONCLUSION

It remains to be seen how the FTC will ultimately respond to the legal challenges. As it now stands, the FTC cannot enforce the Red Flags Rule against physicians based merely on the fact that they defer payment pending insurance reimbursement. It can only enforce the Red Flags Rule against physicians that meet the definition of "creditor" in the Clarification Act, which requires that they must obtain or use consumer reports, reporting to consumer reporting agencies, or advance funds to patients with an obligation of future repayment. And, the ABA decision strongly suggests that the FTC cannot apply the Clarification Act's definition of creditor to either attorneys or physicians without issuing a new rule that provides the opportunity for public comment.

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ⁱPub. L. No. 111–139, 124 Stat. 3457 (to be codified at 15 U.S.C. § 1681m(e)(4)). (The Clarification Act states that a "creditor" is someone who engages in one or more of the following activities "obtains or uses consumer reports, directly or indirectly, in connection with a credit transaction;" "furnishes information to consumer reporting agencies...in connection with a credit transaction;" or "Advances funds to or on behalf of a person based on an obligation to repay the funds." "Creditor" does not include someone who "advances funds on behalf of a person for expenses incidental to a service provided by the creditor to that person." However, the definition does allow for the promulgation of agency rules to expand the definition of "creditor" "based on a determination that such creditor offers or maintains accounts that are subject to a reasonably foreseeable risk of identity theft").

ⁱⁱ*American Bar Association v. FTC*, 636 F.3d 641 (D.C.Cir. 2011).

ⁱⁱⁱ*Id.* at 646–7.