

## **“Red Flags” Rule Update – Mandatory Compliance Date Extended Again**

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### **Introduction**

Since the Federal Trade Commission (“FTC”) and five other agencies first issued final regulations known as the “Red Flags” Rule in January of 2008, the FTC has repeatedly suspended the effective mandatory compliance date and changed the scope of enforcement for the rule. Since the publication of a *Health Law Perspectives* article related to the Red Flags Rule in February 2010,<sup>1</sup> the American Medical Association (“AMA”) and other medical societies filed suit to prevent the FTC from applying the Red Flags Rule to physicians. The FTC, in May of this year, once again indefinitely extended the enforcement date of the Red Flags Rule as applied to physicians after entering into a stipulation with the AMA and the other medical societies that filed suit. Further, members of Congress have attempted to clarify the scope of the Red Flags Rule enforcement through H.R. 3763, H.R. 6420, and S.3987.

### **Background & Updates**

In 2003, Congress enacted the Fair and Accurate Credit Transactions Act (“FACTA”), which amended and modernized the 1970 Fair Credit Reporting Act (“FCRA”).<sup>2</sup> Congress amended the FCRA with the intent of preventing identity theft, improving resolution of consumer disputes, improving the accuracy of consumer records, and making improvements in the use of, and consumer access to, credit information.<sup>3</sup> Under section 114 of FACTA, Congress mandated that the FTC, the National Credit Union Administration (“NCUA”), and four other federal banking agencies<sup>4</sup> (referred to collectively as “the Agencies”) develop and maintain regulations containing identity theft guidelines for use by financial institutions and creditors.<sup>5</sup> The Agencies elected to enact these regulations via the § 553 notice-and-comment rulemaking procedures of the Administrative Procedure Act.<sup>6</sup> The Agencies first published these proposed regulations, known as the Red Flags Rule, in the Federal Register on July 18, 2006.<sup>7</sup> After a notice and comment period, the final version of the regulations was published on November 9, 2007.<sup>8</sup> The final regulations came into effect on January 1, 2008 and had an initial mandatory compliance date of November 1, 2008.

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<sup>1</sup> See Cynthia S. Marietta, J.D., LL.M. (Health Law), *Licensed Health Care Professionals Seek Commitment from FTC on Application of the Red Flags Rule* (Feb. 2010), available at <http://www.law.uh.edu/healthlaw/perspectives/2010/%28CM%29%20RedFlag.pdf>.

<sup>2</sup> Pub. L. No. 108-159, 116 Stat. 1952 (2003) (codified as amended at 15 U.S.C. § 1681 *et seq.*).

<sup>3</sup> *Id.* at 117 Stat. 1953.

<sup>4</sup> Off’c of the Comptroller of the Currency, Treasury (OCC); Bd. of Governors of the Federal Reserve System; Fed. Deposit Ins. Corp. (FDIC); and the Off’c of Thrift Supervision, Treasury (OTS).

<sup>5</sup> Pub. L. No. 108-159, 116 Stat. 1952 at 1960 (2003) (codified as amended at 15 U.S.C. § 1681 *et seq.*).

<sup>6</sup> 5 U.S.C. § 553.

<sup>7</sup> 71 Fed. Reg. 40,786 (July 18, 2006).

<sup>8</sup> 72 Fed. Reg. 63718 (Nov. 9, 2007).

The Red Flags Rule requires financial institutions and creditors to develop and implement a written Identity Theft Prevention Program to detect, prevent, and mitigate identity theft in connection with certain existing accounts or the opening of certain accounts. Noncompliance with the rule can result in injunctive relief and fines up to \$3,500 per violation.

The Agencies did not indicate in the promulgated or final rule or at any time during the comment period that they planned to include physicians, healthcare providers, or attorneys under the definition of “creditor.” However, after the Rule came into effect, the FTC slowly revealed that its scope of enforcement was much larger than they originally indicated and included many businesses that did not traditionally think of themselves as creditors.

As a result of the confusion surrounding the scope of the Red Flags Rule enforcement, the FTC extended the “mandatory compliance date” on five separate occasions since its initially scheduled enactment date. Often these extensions were issued within days of the compliance date. The date was first suspended to May 1, 2009 via a press release that was issued on Oct. 22, 2008 - a mere ten days before the initial enactment date.<sup>9</sup>

On April 30, 2009, the FTC indicated that it would extend the compliance date for a second time and for the first time indicated that it would consider physicians who don't require payment at the time of providing care as "creditors" under FACTA. This position was revealed in a footnote to a three-page document posted on the FTC's website entitled "FTC Extended Enforcement Policy: Identity Theft Red Flags Rule, 16 CFR 681.1."<sup>10</sup>

Since that release, the FTC has indicated that it clearly does consider some physicians and attorneys to be “creditors” under the terms of the Rule. In a May 2009 article, specifically speaking to physicians, the FTC indicated:

Although you may not think of your practice as a 'creditor' in the traditional sense of a bank or mortgage company, the law defines 'creditor' to include any entity that regularly defers payments for goods or services or arranges for the extension of credit. For example, you are a creditor if you regularly bill patients after the completion of services, including for the remainder of medical fees not reimbursed by insurance. Similarly, health care providers who regularly allow patients to set up payment plans after services have been rendered are creditors under the Rule.<sup>11</sup>

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<sup>9</sup> Press Release, *FTC Will Grant Six-Month Delay of Enforcement of 'Red Flags' Rule Requiring Creditors and Financial Institutions to Have Identity Theft Prevention Programs* (Oct. 22, 2008).

<sup>10</sup> Press Release, *FTC Extended Enforcement Policy: Identity Theft Red Flags Rule, 16 CFR 681.1* (Apr. 30, 2009).

<sup>11</sup> Fed. Trade Comm'n, Press Release, *The 'Red Flags' Rule: What Health Care Providers Need to Know About Complying with New Requirements for Fighting Identity Theft*. (May 13, 2009), available at <http://www.ftc.gov/bcp/edu/pubs/articles/art11.shtm>.

## Litigation Update

The American Bar Association (“ABA”) filed a challenge to the FTC’s application of the Red Flags Rule to lawyers on August 27, 2009 in The U.S. District Court for the District of Columbia. On December 1, 2009, the Court issued an opinion in the case holding that the FTC lacked authority to regulate attorneys as creditors under FACTA, and that even if the FTC possessed such authority, the FTC’s implementation of the Red Flags Rule was unreasonable.<sup>12</sup>

On May 21, 2010, the American Medical Association, the American Osteopathic Association and the Medical Society for the District of Columbia filed a similar suit in The U.S. District Court for the District of Columbia asking that the Red Flags Rule be declared void as applied to physician members of their organizations.<sup>13</sup> On August 16, 2010, twenty six other medical societies filed a motion to intervene as plaintiffs and requested relief for all physicians and their practice groups.<sup>14</sup>

Their suit alleges, among other things, that:

1. the FTC failed to follow the notice-and-comment rulemaking procedures of §553 of The Administrative Procedure Act when applying the Red Flags Rule to physicians<sup>15</sup>;
2. the FTC acted beyond the authority given to it by FACTA, the authorizing statute, in applying The Red Flags Rule to physicians who do not require payment at the time of providing care to the patient<sup>16</sup>; and
3. application of the Red Flags Rule to physicians is arbitrary, capricious, and contrary to law and its application to physicians is therefore unlawful.<sup>17</sup>

On June 25, 2010, the FTC entered into a joint stipulation with the AMA agreeing to hold the *AMA v. FTC* case in abeyance until the United States Court of Appeals for the District of Columbia Circuit issues an opinion for the appeal in *ABA v. FTC*. The FTC, in return, agreed not to enforce the Red Flags Rule against the physician members of the medical associations and state medical societies named in the original complaint until ninety days after the re-opening of *AMA v. FTC*.<sup>18</sup>

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<sup>12</sup> *American Bar Ass’n v. FTC*, 671 F.Supp.2d 64 (DDC 2009)

<sup>13</sup> Complaint, *American Medical Ass’n v. FTC*, Case No. 1:10-cv-00843-RBW (DDC May 21, 2010)

<sup>14</sup> Motion to Intervene, *American Medical Ass’n v. FTC*, Case No. 1:10-cv-00843-RBW (DDC Aug. 16, 2010)

<sup>15</sup> Complaint, *American Medical Ass’n v. FTC* at 26, Case No. 1:10-cv-00843-RBW (DDC May 21, 2010)

<sup>16</sup> *Id.* at 24

<sup>17</sup> *Id.* at 25

<sup>18</sup> Joint Stipulation, *American Medical Ass’n v. FTC* at 26, Case No. 1:10-cv-00843-RBW (DDC May 21, 2010) The AMA has provided a copy of the stipulation, *available at*: <http://www.ama-assn.org/ama1/pub/upload/mm/395/ama-ftc-joint-stipulation.pdf>.

## Legislative Update

The Chair of the FTC, Jon Leibowitz, while speaking at the American Medical Association Annual Meeting on June 14, 2010, conceded that the Red Flags Rule “reaches too far.” The FTC, however, has taken the position that they cannot exempt any categories or professions of businesses from the rule without a legislative fix.<sup>19</sup>

On October 8, 2009, Rep. John Adler introduced H.R. 3763, which would exempt certain businesses from the Red Flags Rule. Businesses excluded by the Bill include health care practices, accounting practices and legal practices with twenty or fewer employees. Other businesses that would be eligible to apply for exclusions on a case by case basis include those that know all of their customers or clients individually, those that only perform services in or around the residences of their customers, and those that have not experienced incidents of identity theft and in which identity theft is rare for businesses of that type.<sup>20</sup>

The Bill passed in the House, and was referred to the Senate Committee on Banking, Housing, and Urban Affairs as S. 3416 on October 21, 2009. The Bill was set to be heard on May 25, 2010, according to the legislative calendar. However, as of the writing of this article, the Bill has not been marked up in committee and has not been rescheduled on the calendar.

A similar Bill entitled the “Red Flag Program Clarification Act of 2010” was introduced by Rep. Adler in the House on November 17, 2010 as H.R. 6420.<sup>21</sup> The Senate this time, however, chose not wait for the House to take action on H.R. 6420. Senator John Thune introduced S.3987, a Bill that is identical to H.R. 6420, on November 30, 2010.<sup>22</sup> S.3987 was passed by the Senate the same day that it was introduced. It has now been referred to the House Committee on Financial Services.

To clarify the scope of the Red Flags Rule, the “Red Flag Program Clarification Act of 2010” would amend the FCRA to include a modified definition of “creditor.” Under the modified version the term “creditor” under the Red Flag Program:

(A) would mean a creditor, as defined in section 702 of the Equal Credit Opportunity Act (“ECOA”),<sup>23</sup> that regularly and in the ordinary course of business--

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<sup>19</sup> Victoria Stagg Elliott, *FTC Chair: Doctors Shouldn't Be Under "Red Flags" Rule* June 28, 2010, available at <http://www.ama-assn.org/amednews/2010/images/prhd0628.pdf>.

<sup>20</sup> H.R. 3763, 111<sup>th</sup> Cong. (2009).

<sup>21</sup> H.R. 6420, 111<sup>th</sup> Cong. (2010).

<sup>22</sup> S.3987, 111<sup>th</sup> Cong. (2010).

<sup>23</sup> The term “creditor” under section 702 of the ECOA is defined as any person who regularly extends, renews, or continues credit; any person who regularly arranges for the extension, renewal, or continuation of credit; or any assignee of an original creditor who participates in the decision to extend, renew, or continue credit. Codified at 15 U.S.C. 1691a.

- (i) obtains or uses consumer reports, directly or indirectly, in connection with a credit transaction;
- (ii) furnishes information to consumer reporting agencies, as described in section 623 of the ECOA, in connection with a credit transaction; or
- (iii) advances funds to or on behalf of a person, based on an obligation of the person to repay the funds or repayable from specific property pledged by or on behalf of the person;

(B) would not include a creditor described in subparagraph (A)(iii) that advances funds on behalf of a person for expenses incidental to a service provided by the creditor to that person; and

(C) would include any other type of creditor that the FTC, the National Credit Union Administration (“NCUA”), and the federal banking agencies named in paragraph one of 15 U.S.C. §1681m(e) may determine is an appropriate creditor through the rule making process provided that the creditor fits under the ECOA definition of creditor and that the rule is based on a determination that such creditor offers or maintains accounts that are subject to a reasonably foreseeable risk of identity theft.<sup>24</sup>

As stated in by Senator Thune in colloquy on the floor in support of “Red Flag Program Clarification Act of 2010”,

only a ”creditor” that regularly and in the ordinary course of its business obtains or uses consumer reports in connection with a credit transaction, furnishes information to consumer reporting agencies in connection with a credit transaction, or advances funds would be required to develop and implement a written identity theft prevention and detection program.<sup>25</sup>

He went on to state that “the legislation makes clear that an advance of funds does not include a creditor’s payment in advance for fees, materials, or services that are incidental to the creditor’s ability to provide another service that a person initiated or requested.”<sup>26</sup> The “Red Flag Program Clarification Act of 2010”, would therefore, if passed, remove physicians, dentists, attorneys, and accountants from the scope of the Red Flags Rule enforcement.

#### Indefinite Extension of Enforcement Date to December 2010

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<sup>24</sup> H.R. 6420, 111<sup>th</sup> Cong (2010).

<sup>25</sup> 156 Cong. Rec. S8288-01, 2010 WL 4861255 (Cong.Rec.).

<sup>26</sup> *Id.*

On May 28, 2010, “at the request of several members of Congress,” the FTC extended the enforcement date for the Red Flags Rule for a fifth time.<sup>27</sup> As of this writing, the enforcement date of the Red Flags Rule has been set to December 31, 2010, or “if Congress passes legislation limiting the scope of the Red Flags Rule with an effective date earlier than December 31, 2010, the Commission will begin enforcement as of that effective date.” However, the FTC has also announced that, in accordance with their stipulation in *AMA v FTC*, if the issue isn't settled by Congress before Jan. 1, 2011, the Agency would not enforce the rule against members of several medical societies, including the AMA, until the American Bar Association case against the FTC is resolved in the D.C. Circuit Court of Appeals.<sup>28,29</sup>

### Is the FTC Position Correct?

In an email sent to the AMA a few days after he spoke at the AMA annual meeting, Chairman Liebowitz stated,

we do not have the authority to exempt any categories or professions of businesses from the rule... As required by Congress, the rule applies to 'creditors,' as defined under the Equal Credit Opportunity Act. This definition has an unusually broad scope and includes entities that regularly permit deferred payments for goods or services. ... Congress has also acknowledged that this is a problem that requires a legislative fix.<sup>30</sup>

It appears likely, however, that courts will not agree with this position. The District Court for the District of Columbia, in *ABA v FTC*, agrees with the AMA claim that the FTC acted beyond the authority of FACTA, the authorizing statute, in applying the Red Flags Rule to certain professional services. Additionally, it appears that the FTC not only had authority to exclude certain professional services under the definition of creditor, but in fact, did not have proper legislative authority to include certain professional services under the definition of “creditor.”

The Court in *ABA v FTC* states a number of reasons why it held that the FTC acted beyond the scope of FACTA. Under *Chevron, U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, the U.S. Supreme Court fashioned a test to determine whether an agency's regulation or rule exceeds legislative authority.<sup>31</sup> For the sake of brevity, in this article we only address the first prong of *Chevron*, which in and of itself is sufficient to show that the FTC acted beyond the scope of FACTA. Under a *Chevron* analysis, the Court first examines if “Congress [expressed] an intention on the precise question at issue.” If Congress spoke implicitly or explicitly on the matter, then “that intention is the law and must be given effect.”<sup>32</sup>

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<sup>27</sup> Fed. Trade Comm'n, Press Release, *FTC Extends Enforcement Deadline for Identity Theft Red Flags Rule* (May 28, 2010), available at <http://www.ftc.gov/opa/2010/05/redflags.shtm>.

<sup>28</sup> Elliott, *supra* note 19.

<sup>29</sup> Joint Stipulation, *supra* note 18.

<sup>30</sup> Elliott, *supra* note 19.

<sup>31</sup> *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

<sup>32</sup> *American Bar Ass'n v. FTC*, 671 F.Supp.2d 64at 73 (DDC 2009).

The Court found that under the language of FACTA, Congress did not authorize the FTC to include certain professional services under the scope of FACTA. The Court, when analyzing whether or not Congress granted the FTC the authority to regulate attorneys as creditors, stated the scope of the term “creditor” as applied by the FTC beyond the credit industry was too broad. The Court stated that Congressional selection of the terms “‘financial institution’ along with ‘creditor’ as the targets of the legislation implies that [FACTA] was created to apply to entities involved in banking, lending, or financial related business”... and that FACTA was not “created as a means of eliminating all types of identity theft, but rather to eliminate a specific kind of identity theft: identity theft in the credit industry.”<sup>33</sup>

The Court also noted that if Congress intended FACTA to apply to attorneys “it would have used the appropriate terminology to denote that intent and not hidden it in a statute expressly targeted at the credit industry.”<sup>34</sup> Even if there was some ambiguity in the authorizing statute, “that lack of clarity... cannot reasonably be interpreted as either an explicit or implicit grant to the Commission to ‘cure th[e] ambiguity’ by regulating attorneys, given that the regulation of the legal profession has been left to the prerogative of the states.” The Court relied on *Will v. Mich. Dep’t of State Police* to show that, “[I]f Congress intends to alter the usual constitutional balance between the States and the Federal Government, it must make its intention to do so unmistakably clear in the language of the statute.”<sup>35</sup>

Similar language can be found in prior opinions concerning legislative intent concerning the healthcare industry and the practice of medicine. For instance, in *Gonzalez v. Oregon*, The Supreme Court states that the regulation of the practice of medicine is generally a field left to the prerogative of the States and that “when Congress wants to regulate medical practice in the given scheme, it does so by explicit language in the statute.”<sup>36</sup>

### Conclusion

In light of *ABA v FTC*, the ongoing suit between the AMA and the FTC, the repeated indefinite extension of the mandatory compliance date for the Red Flags Rule, recent comments made by the FTC Chair, and proposed legislation to amend FACTA in Congress, it appears that the Red Flags Rule, more than likely, will never be enforced against physicians in its current form.

Physicians, however, would still be well advised to develop or revisit their identity theft policies with the Red Flags Rule in mind. The Red Flags Rule may still be enforced if *ABA v FTC* is reversed on appeal and if Congress fails to pass the Red Flag Program Clarification Act of 2010, or similar legislation. The fact that medical identity theft is one

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<sup>33</sup> *Id.* at 74.

<sup>34</sup> *Id.* at 75; *See Whitman v. Am. Trucking Ass’ns*, 531 U.S. 457 at 468 (2001) (“[Congress] does not ... hide elephants in mouseholes.”).

<sup>35</sup> *Will v. Mich. Dep’t of State Police*, 491 U.S. 58 at 65 (1989).

<sup>36</sup> *Gonzalez v. Oregon*, 546 U.S. 243, 270 (2006).

of the fastest growing forms of identity theft in the United States should also be a reminder to physicians that, for a number of other reasons that go beyond the threat of enforcement of the Red Flags Rule, physician practices should either create or review and update their medical identity theft policies.

**Post Publication Note:** An E-health Law professor once said to me that he contemplated putting together an E-Health Law text. He, however, was hesitant to do so. He expressed a concern that, because the field of E-Health Law changes so rapidly, any text put together would be obsolete within a matter of months and require constant revisions.

The matters discussed within this article are no exception to the ever changing field of E-health law. A number of developments surrounding “The Red Flags Rule” came about while this article was being prepared for publication and immediately after it was published.

This article was originally published on December 8, 2010. One day prior to its publication, the House passed “The Red Flag Program Clarification Act” which, as discussed in this article, was passed in the Senate in late November. On December 9, 2010 “The Red Flag Program Clarification Act” was sent to the President and then subsequently signed into law as Public Law 111-319. As a result, physicians, dentists, attorneys, and accountants, for the most part, have been removed from the scope of the Red Flags Rule enforcement.

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