

INTELLECTUAL PROPERTY ALERT

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## Court Prevents FTC from Enforcing Red Flags Rule Against Lawyers

## By Robert M. Bryan and John M. Conley

On December 1, 2009, a federal district court in Washington, D.C. issued an opinion holding that the Federal Trade Commission cannot enforce its long-delayed Red Flags Rule against lawyers. The opinion formalizes an oral ruling issued on October 30. On the same day, the FTC, which has jurisdiction over creditors that are not traditional financial institutions, bowed to Congressional pressure and announced its most recent postponement of its enforcement of the Red Flags Rule, this time until June 1, 2010.

This case may affect more than lawyers. On April 30, 2009, the FTC—to the surprise of many professional communities—had announced that it would enforce the Red Flags Rule against any "businesses or organizations that regularly provide goods or services first and allow customers to pay later." According to the FTC, examples of groups that may fall within this definition include utilities, health care providers, lawyers, accountants, and other professionals.

In responding to a suit by the American Bar Association, the court held that the FTC had no authority to extend the Rule to lawyers because that had never been Congress' intent. The court emphasized that the Rule adopts a definition of "creditor" that derives from the 1974 Equal Credit Opportunity Act (the "ECOA"), and which depends in turn on the ECOA's definition of "credit": "the *right* granted by a creditor to a debtor to defer payment" (emphasis by the court). After an exhaustive review of the ECOA's definitions, the court found that the customary practice of billing clients after services are rendered creates no *right* to defer payment, and that FTC regulation would intrude on the states' traditional regulation of the legal profession. The court held that the FTC's interpretation was plainly wrong, and thus an unlawful extension of the FTC's authority.

It is too early to say exactly how far-reaching this decision may be, but early indications are that it may well be extended to other professions. Although it is only a district court opinion that the FTC may decide to appeal, it is thoroughly researched and very well-reasoned. The logic is clearly applicable to other occupations, especially those that have been traditionally regulated by the states. A parallel lawsuit has already been filed on behalf of accountants, and groups representing retailers, securities dealers, and health care providers have publicly adopted the ABA's arguments. In addition, a bill has passed the House of Representatives (H.R. 3763) and gone to the Senate that would exclude from the "creditor" category any health care practice, accounting practice, or legal practice with 20 or fewer employees. Another exclusion in the bill would cover businesses that know their clients individually, which would probably include larger professional practices. This is another indication that Congress is worried about the economic impact of Red Flags compliance, and that it will continue to scrutinize the FTC's approach.

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