

FTC Starts Enforcement of "Red Flags" Rule

by Devala Janardan, Associate Counsel

The Federal Trade Commission (FTC) started enforcement of the oft-delayed "Red Flags" Rule on December 31, 2010.[1] A brief discussion follows below on the basics of the Red Flags Rule, but of importance in this article is that President Obama signed into law the Red Flag Program Clarification Act of 2010 ("Clarification Act") on December 18, 2010, which addresses the definition of "creditor" for purposes of the Red Flags Rule.

As a quick review, the Red Flags Rule falls under the Fair and Accurate Transactions Act[2] (FACTA) and aims for businesses and organizations to do the following: 1) identify the warning signs—or "red flags"—of identity theft; 2) implement written procedures to detect red flags; 3) respond appropriately to prevent and mitigate identity theft; and 4) continually monitor and update the procedures in place.[3]

Some examples of red flags are: 1) alerts, notifications and warnings from a credit reporting company; 2) suspicious documents (e.g., identification looks altered or forged, person presenting identification doesn't match physical description noted on document, information on document differs from what person presenting the information says); 3) suspicious personal information (e.g., person can't answer anything more than what is on the form, information that has been used on other accounts and social security number doesn't correspond to date of birth); 4) suspicious account activity (e.g., account that has not been used in a long time suddenly used again, requests for new cards immediately after a change of address notification); and 5) notice from other resource, such as law enforcement.

Some examples of responses you can take to prevent and mitigate identify theft include monitoring an account, contacting the customer, changing passwords or security codes, closing an existing account, reopening an account with a new account number, not opening a new account, and notifying law enforcement. If your local entity client has not implemented a plan, you should move quickly on getting one in place. IMLA does not offer a model/sample Red Flags Rule policy, but various state and municipal leagues have done so.[4]

The Red Flags Rule applies to "financial institutions" and "creditors." The pre-December 18th definition[5] of "creditor" relied on the definition included in the Equal Opportunity Credit Act, and included anyone who "regularly extends, renews, or continues credit" or "regularly arranges for the extension, renewal, or continuation of credit."[6] The FTC, in April 2009, released an Extended Enforcement Policy, which clarified the definition of "creditors" to include "all entities that deferred payment for goods and services," including lawyers, physicians (health care organizations), accountants, and others who bill their clients after services are rendered.[7] In response, the American Bar Association sued the FTC on Tenth Amendment grounds, claiming that, absent a clear directive by Congress, states retain the power to regulate the practice of law.[8] This, and other similar lawsuits by organizations such as the American Medical Association, served as the catalyst for the Clarification Act.

The Clarification Act defines "creditor" as one who: "(i) obtains or uses consumer reports, directly or indirectly, in connection with a credit transaction; (ii) furnishes information to consumer reporting agencies . . . 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.[9] Creditors who advance funds or expenses incidental to a service provided by the creditor to that person are exempt.

What does this mean for you? Well, if you are IMLA Associate Member (i.e. private law firm), then this possibly means that your law firm is now exempt from the Red Flags Rule for merely billing your clients for services provided. For municipalities, this still means your public utilities are likely to still fall under the Red Flags Rule, but it is less clear if the Rule applies if a specific municipal department is not directly or indirectly obtaining or using consumer reports in connection with a credit transaction. For example, what if you have setup a payment plan for an individual for a license fee or fine? It is arguable that this arrangement would have been included in the pre-December 18th definition of "creditor," but not after the enactment of the Clarification Act.

The Clarification Act also provides for continued expansion of the definition of "creditor" by stating that the FTC and other agencies still can use their rule-making authority to designate any group as a "creditor" if the agency determinations that the creditor "offers or maintains accounts that are subject to a reasonably foreseeable risk of identify theft."[10] IMLA will continue to monitor developments concerning the Red Flags Rule for our members.

Notes

1. Red Flag Clarification Act of 2010, Pub. L. No. 111-319 (Dec. 18, 2010).
2. Fair and Accurate Credit Transactions Act of 2003, 15 U.S.C. § 1681 *et seq.* (2009).
3. Federal Trade Commission, *Fighting Fraud with the Red Flags Rule*, pg.14 (2009).
4. *See, e.g.*, http://www.mrsc.org/subjects/pubworks/utilbill/RedFlag.aspx; http://www.lkm.org/resources/ordinances/samples/red-flag-rule.php; http://www.oml.org/npps/section.cfm?SID=30.
5. Fair and Accurate Transactions Act, 15 U.S.C. § 1681a(r)(5) (2009).
6. Equal Opportunity Credit Act, 15 U.S.C. § 1691a(e) (2009).

continued on page 36

The City of Bell

cont'd. from page 9

retirement accounts, may have exceeded $1.5 million.
7. For the *Los Angeles Times* reporter's account, see James Spencer, *The Story of How the Bell Scandal Broke: An Account From LA Times Reporter Jeff Gottlieb*, August 11, 2010, *available at* http://www.publicceo.com.
8. Jeff Gottlieb and Ruben Vives, *supra* note 1.
9. Police Chief Randy Adams, who was receiving a salary of over $450,000, was not charged.
10. Richard Winton, *Attorney general's lawsuit against bell officials could be in jeopardy*, L.A. TIMES, November 5, 2010, *available at* http://www.latimes.com
11. Letter from John Chiang, California State Controller, to Pedro Carrillo, Interim City Administrator, City of Bell, dated Sept. 22, 2010, enclosing the report of the State Controller's Office audit. The letter is available online at http://www.sco.ca.gov/Press-Releases/2010/controller_chiang_2010_bell_audit_letter.pdf.
12. Jeff Gottlieb and Ruben Vives, *Benefits push Bell ex-manager's compensation to more than $1.5 million*, L.A. TIMES, August 8, 2010, *available at* http://www.latimes.com.
13. Paloma Esquivel and Robert J. Lopez, *Times investigation: Bell demanded extra fees from some businesses*, L.A. TIMES, November 2, 2010, *available at* www.latimes.com.
14. Ruben Vives and Richard Winton, *Bell generates big money from towing cars; resident demands investigation*, L.A. TIMES, August 2, 2010, *available at* www.latimes.com.
15. Paul Pringle, *Did Steve Cooley's office neglect Bell probe?* L.A. TIMES, October 28, 2010, *available at* http://www.latimes.com.
16. Steve Lopez, *The bleeding Bell blues*, L.A. TIMES, July 21, 2010, *available at* http://www.latimes.com.
17. Paul Pringle, Corina Knoll and Kim Murphy, *Rizzo's horse had come in*, L.A. TIMES, August 22, 2010, *available at* http://www.latimes.com.
18. The survey may be accessed online at http://www.cacities.org/compensationsurvey.
19. The Institute for Local Government has resources on public engagement and collaborative governance on their website at http://www.ca-ilg.org.
20. For examples of social media policies that California cities have adopted, go to http://www.cacities.org/socialmediaresources. ML

Federal

cont'd from page 18

7. Fed. Trade Comm'n, *FTC Extended Enforcement Policy: Identify Theft Red Flags Rule*, 16 CFR 681.1 (Apr. 30, 2009).
8. Brief for Plaintiff-Appellee, *American Bar Ass'n v. Fed. Trade Comm'n*, No. 10-5057 (Aug. 20, 2010).
9. Red Flag Clarification Act of 2010, Pub. L. No. 111-319 (Dec. 18, 2010).
10. *Id.* ML

Supreme Court

cont'd. from page 23

public nuisance against the owners and operators based on their contributions to global warming. (The City alleged that unrestrained emissions of greenhouse gases would increase the temperature in the City, which would, in turn, increase heat-related deaths, damage the coastal infrastructure, and wreak havoc in its residents' daily lives).

The power companies petitioned for a writ of certiorari, challenging the plaintiffs' standing to bring the actions, the existence of a cause of action to cap carbon dioxide emissions under the federal common law, and the existence of justiciable claims. The questions presented in the case are: (1) Whether states and private parties may seek emissions caps on utilities for their alleged contribution to global climate change; (2) whether a cause of action to cap carbon dioxide emissions can be implied under federal common law; and (3) whether claims seeking to cap carbon dioxide emissions based on a court's weighing of the potential risks of climate change against the socio-economic utility of defendants' conduct would be governed by "judicially discoverable and manageable standards," or could be resolved without "initial policy determination[s] of a kind clearly for nonjudicial discretion." See *American Electric Power Co. v. Connecticut*, 582 F.3d 309 (2d Cir. 2009), *cert. granted*, 2010 WL 4922905 (U.S. December 06, 2010) (No. 10-174). ML

Electronic Signatures

cont'd. from page 27

governmental affairs." UETA § 2(16).
14. 15 U.S.C. § 7001(a); UETA § 7.
15. *See* Thomas J. Smedinghoff and Ruth Hill Bro, *Moving with Change: Electronic Signature Legislation as a Vehicle for Advancing E-Commerce*, 17 J. MARSHALL J. COMPUTER & INFORMATION L. 723 (Spring 1999).
16. 15 U.S.C. § 7001(a).
17. UETA §7(a), (c), and (d).
18. *See* E-SIGN, 15 U.S.C. § 7003, and UETA § 3(b) for a complete list of exceptions.
19. 15 U.S.C. § 7001.
20. *Id.* at § 7002(a).
21. UETA § 5(b).
22. *Id.* and comment 3. Some state enactments of UETA (e.g., California) require such consent to be in electronic form.
23. 15 U.S.C. § 7006(5); UETA, § 2(8) (definitions of "electronic signature").
24. 15 U.S.C. § 7001(a) and 7006(5); UETA, § 2(8) and 7(d).
25. For more on Information Assurance, see http://en.wikipedia.org/wiki/Information_assurance.
26. 15 U.S.C. § 7001(e).
27. UETA § 8(c).
28. *See* FED. R. EVID. 901(a) (1995).
29. *See* Information Security Committee, Electronic Commerce Division, ABA Section of Science & Technology Law, *Digital Signature Guidelines* (Aug. 1996), available at www.abanet.org/scitech/ec/isc/dsgfree.html. One definition of non-repudiation is "[s]trong and substantial evidence of the identity of the signer of a message and of message integrity, sufficient to prevent a party from successfully denying the origin, submission or delivery of the message and the integrity of its contents." *Id.* at § 1.20.
30. *See* FED. R. EVID. 901(b)(9)(1995). ML