

Red Flags Rule

Lawyers Should be Exempt from Regulation Under the FTC's Red Flags Rule

The Federal Trade Commission (FTC) has established a Red Flags Rule (with enforcement to go into effect November 1, 2009) under the Fair and Accurate Credit Transactions Act (FACTA) of 2003 (72 FR 63771). The Rule requires certain creditors to develop and implement written programs to identify, detect, and respond to the warning signs (“red flags”) of identity theft. The FTC plans to apply the Rule to lawyers and law firms even though lawyers are not engaged in the type of commercial activity that Congress was trying to regulate and thus should not be considered “creditors.”

The FTC and Congress should exempt lawyers from the Red Flags Rule because:

- **FACTA was not intended to cover lawyers and does not require the FTC to cover lawyers under the Red Flags Rule.** Nowhere in FACTA did Congress even imply an intention to regulate lawyers. The FTC previously attempted to regulate lawyers under the Gramm-Leach-Bliley Act, but the D.C. Circuit Court found that “the regulation of the practice of law is traditionally the province of the states” and that federal law “may not be interpreted to reach into areas of state sovereignty unless the language of the federal law compels the intrusion.”
- **The manner in which lawyers bill is not an extension of credit.** Lawyers practice under an unusual, if not unique, stringent ethical system in which legal fees are subject to sanction if they are deemed excessive under established standards. The charging of excessive fees is in and of itself an ethical violation. Therefore, regardless of the specifics of billing arrangements in client-lawyer relationships, a fee cannot be charged unless and until services are rendered. Since that is the earliest time a client could be billed, the fact that the service precedes the billing does not make the billing deferred and is thus not an extenuation of credit.
- **Failure to apply the Red Flags Rule to lawyers would not increase the risk of identity theft.** Developing a program under the Rule is a resource-intensive task even for a low-risk entity like a law firm; the burden of lawyer compliance with the Red Flags Rule far outweighs any perceived benefit a client might receive. The FTC has been unable to provide one single incident of identity theft arising from a law practice context. The identity theft addressed by the Rule would be present only if an individual pretended to be someone else either to fraudulently initiate a client-lawyer relationship or to obtain legal services on the pretext that the person is another individual who is already a client of a lawyer. Therefore, a person would not only have to assume another person's identity, but his or her legal needs as well.

Lawyers are not creditors, and the FTC and Congress should take steps to ensure that when the final Red Flags Rule goes into effect, the Rule will not apply to lawyers engaged in the practice of providing legal services to clients.