

Identity-theft protection faces unexpected obstacle

Identity theft is a serious crime with a devastating impact. In an age where sensitive personal information is routinely pilfered and exploited, no one would object to the enactment of laws aimed at combating this epidemic.

Why, then, would an effort to strengthen protections against identity theft be facing stiff resistance?

The issue concerns the Fair and Accurate Credit Transactions Act (FACTA), a 2003 Federal Trade Commission law enacted to protect consumers in dealing with credit transactions. FACTA's sweeping provisions strengthened control over personal data and information sharing.

But in one pivotal area — the dreaded "Red Flag Rule" — support has turned to intense rejection, and the law now is spinning its wheels. Your business could be affected.

The Red Flag Rule is an anti-fraud regulation that requires extensive measures to continually monitor, identify, detect and alert consumers to any suspicious activity that could be a warning sign of identity theft. These include unusual patterns in spending, suspicious or questionable

documents, uncharacteristic use of a Social Security number, suspicious use of phone numbers and so forth. The law requires implementation of formal programs to search for red flags and to undertake notification and other protective measures the moment they're identified.

But the law caused an uproar the moment it hit the ground, not because of its intent or the protection afforded, but because of the sheer magnitude of resources needed to implement a Red Flag Rule program. That's because FACTA imposes the Red Flag Rule on "creditors" — and therein lies the problem.

In what could be an all-time classic example of a law being overbroad in scope, the FTC declared that the term "creditor" included any business that "provides products or services for later payment."

For banks, credit unions, lenders and such, financial data management is already their principal activity, so Red Flag Rule compliance would more easily fit within existing operations. But the FTC's proposed broad interpretation of "creditor" went way beyond this, and applied to virtually any business that performs services and later charges for them.

The FTC's broad definition sparked outrage among businesses that aren't designed or staffed to monitor vast amounts of customer financial data, or to constantly alert customers to suspicious activity. As a result, the FTC has been besieged with complaints from doctors, dentists, CPAs, contractors and, yes, lawyers, because

their businesses meet the FTC's statutory definition — since in most cases they render services for later payment — but they aren't set up or staffed to operate a Red Flag Rule department.

The net result is that the Red Flag Rule has met with enormous opposition from trade organizations seeking to shield their members from the rule's requirements. A few courts have addressed this issue and seem to acknowledge that, best of intentions aside, the FTC went too far.

Ironically, or perhaps appropriately depending on how you look at it, the American Bar Association was the first to obtain an exemption. Last October, a federal court in the District of Columbia granted the ABA's motion to exempt law firms from the unreasonable burden of having to devote resources to Red Flag Rule compliance.

The American Medical Association, American Dental Association, telecommunications firms, car dealers, utility companies and many others initiated similar proceedings seeking exemptions.

The FTC can still appeal the ABA ruling, and so far is sticking to its position that law firms and other service providers fall within the plain meaning of the statute and shouldn't be treated differently. Opponents argue that the law was intended for the financial community, not for just any company that bills for goods and services after they've been furnished.

One commentator observed that, under the FTC's broad definition, even a

restaurant technically would need a Red Flag Rule program, because food is delivered for "later payment." What about cab drivers, plumbers and parking lots? Only amusement parks, movie theatres and retail stores, it seems, would escape the definition.

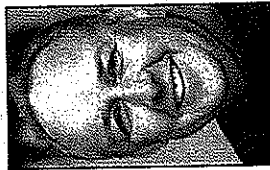
Still, there are signs the FTC may back off. The original compliance deadline of November 2008 repeatedly has been pushed back, and most recently the AMA succeeded in persuading the FTC to move the compliance date to June 2010.

For any business that renders goods or services and gets paid later, it would be a good idea to monitor these events to determine whether the Red Flag Rule requirements apply.

Information concerning FACTA and the Red Flag Rule can be tracked at the FTC website, www.ftc.gov, through the Privacy Rights Clearinghouse at www.privacyrights.org or through the websites of virtually any large trade organization.

Hopefully, a resolution will be reached that recognizes the need to ensure consumer protection but also the reality faced by businesses, both large and small, who may have to limit or reduce other services if it becomes necessary to comply with the Red Flag Rule.

DAVID SCHACHTER, a member of the Denver law firm of Sherman and Howard LLC, and who specializes in intellectual property and technology law, can be reached at 303-299-8385 or dschachter@sah.com.



David Schachter