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National Independent Automobile Dealers Association

Association and Antitrust Law Training

Friday, February 5, 2021
3-4 PM CT

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Agenda

- Association Law Basics
  - Nonprofit corporate law
  - Federal tax exemption
    - 501(c)(6) organizations
    - 501(c)(3) organizations
- Antitrust Law Basics
- Application of the Antitrust Laws to Associations
- Association Antitrust Compliance Programs
- Q&A

Nonprofit Law Basics – Nonprofit v. Tax-Exempt Status

- There is a notable difference between a nonprofit organization's "nonprofit" corporate status and its federal "tax-exempt" status; once a "nonprofit" corporation is formed, it does not automatically become federally "tax-exempt" (by default, it would be a taxable nonprofit corporation without IRS tax-exemption recognition)
- Despite the name, "nonprofits" are not limited in the profits they can earn; it is just that nonprofits have no owners/shareholders and all profits must be reinvested in the corporation in furtherance of its nonprofit mission and purposes
- A nonprofit corporation is organized under the laws of one of the 50 states or DC; most of these laws are based on the American Bar Association's Model Nonprofit Corporation Act; NIADA is incorporated as a Delaware nonstock/nonprofit corporation
- State nonprofit corporation statutes regulate a wide array of governance, operations and activities of nonprofit corporations; they also contain "default" provisions
- A nonprofit corporation's internal governance rules (e.g., Bylaws, policies) must be consistent with the nonprofit corporation statute of the state of incorporation; hierarchy is as follows: state nonprofit corporate statute, Articles of Incorporation, Bylaws, policies

Federal Tax-Exempt Status – Overview

- The vast majority of all nonprofit corporations are recognized as exempt from federal corporate income tax under Section 501(c)(3) of the Internal Revenue Code; this tax-exempt status provides numerous benefits but also imposes some limitations and prohibitions
- Other nonprofit corporations are recognized as exempt from federal corporate income tax under other sections of the Internal Revenue Code (e.g., Sections 501(c)(6) and 501(c)(4)); NIADA is tax-exempt under Section 501(c)(6), while the NIADA Foundation is tax-exempt under Section 501(c)(3)
- Federal tax-exempt status is generally recognized through the filing of an application with the IRS for recognition of such tax-exempt status (e.g., IRS Form 1023 or 1024)
- Tax-exempt entities are required to file some form of the IRS Form 990 each year, and are required to file the IRS Form 990-T (and make quarterly estimated tax payments) if unrelated business income (UBI) is earned
- Recognition of federal tax-exempt status can generally be utilized to confer virtually automatic exemption from state corporate income tax (in the state in which the organization's principal office is located (not the state of incorporation))

Federal Tax-Exempt Status – Private Inurement and Private Benefit

- The "private inurement" doctrine is applicable to most categories of tax-exempt entities but the "private benefit" doctrine is only applicable to 501(c)(3) entities (and arguably 501(c)(4)s)
- The private inurement doctrine prohibits paying excessive compensation (greater than fair market value) to those with an ability to exercise substantial influence over the organization, such as officers, directors and key employees, and sometimes others such as founders)
- All tax-exempt entities can potentially lose their tax-exempt status for private inurement, but only 501(c)(3) and 501(c)(4) entities are subject to "intermediate sanctions" (excise taxes) on such excessive compensation – both on the recipients of the compensation and on those who approved it
- The "rebuttable presumption of reasonableness" can significantly help protect against IRS findings of private inurement and the imposition of intermediate sanctions, and should be a best practice for *all* tax-exempt entities:
  - Compensation should be set in reliance on *appropriate* comparability data;
  - Compensation decisions should be made by *independent* decision-makers, with appropriate recusal by the recipient(s) of such compensation; and
  - This process should be *contemporaneously* documented
- The private benefit doctrine requires that, on balance, the a 501(c)(3) entity must confer more benefits on the public than on private parties, both *quantitatively* and *qualitatively;* only "impermissible" private benefit is prohibited – some private benefit is inherent in many activities and operations of 501(c)(3) organizations

Federal Tax-Exempt Status – Other Taxes; Subsidiaries and Affiliates

- Exemption from federal corporate income tax does not automatically confer exemption from other forms of federal, state and local taxes (e.g., unrelated business income tax (UBIT), federal payroll taxes, state and local sales/use taxes and property taxes)
- In most states, cities and counties, 501(c)(3) tax-exempt status is a prerequisite to state sales/use and property tax exemption but there are usually additional requirements as well
- Tax-exempt organizations are permitted to have taxable and tax-exempt subsidiaries and affiliates, both recognized as separate legal entities for federal income tax purposes (both taxable and tax-exempt) and as "disregarded" entities (e.g., LLCs)
- Subsidiaries and affiliates are used for a variety of purposes, such as being able to engage in activities prohibited or limited by the parent's tax-exempt status, liability protection, funding opportunities, government grant/contract indirect cost rates, public charity status, joint ventures, to enable multiple owners and facilitate investment and sale, public perception, separate IRS Forms 990, and separate governance structures
- There are limitations and prohibitions on the ability to transfer funds and resources between and among certain tax categories of parents, subsidiaries and affiliates
- Common examples of subsidiaries and (controlled) affiliates include related advocacy arms, related foundations, taxable subsidiaries, chapters, and (single- and multi-member LLCs; there are a variety of mechanisms for exercising direct and indirect control over subsidiaries and affiliates

Federal Tax Exemption – 501(c)(6) (e.g., NIADA)

- 501(c)(6) tax-exempt purposes – to promote, further and advance the industry or profession represented by the organization; most are membership associations or chambers of commerce
- Exemption from federal and state corporate income tax
- Contributions not tax-deductible as charitable contributions but *usually* will be deductible as business expenses
- No "private inurement" – i.e., no payment of greater-than-fair-market-value compensation to "insiders" (those with an ability to exercise substantial influence over the organization, such as directors, officers and employees), but no intermediate sanctions available to the IRS
- Political campaign activities cannot constitute more than half of the organization's overall activities – distinguished from lobbying, which has no limitation for 501(c)(6) organizations as long as mission-related
- Taxation of unrelated business income ("UBIT"); OK to earn UBI but cannot be more than "insubstantial"; net income is taxed at the flat 21% federal corporate income tax rate; most common form is advertising income; numerous exceptions to UBIT (e.g., royalties, corporate sponsorships, convention and trade show income, investment income)

Federal Tax Exemption – 501(c)(3) (e.g., NIADA Foundation)

- 501(c)(3) tax-exempt purposes – educational, scientific, charitable, relieving the burdens of government
- Exemption from federal and state corporate income tax
- Benefits: Contributions generally tax-deductible by donors as charitable contributions (less the value of benefits received in return); charitable bequests also permissible; eligibility for many federal, state and local government and private foundation grants
- No “private inurement”
- No impermissible “private benefit”
- No “substantial” lobbying
- No political campaign activities (e.g., this includes volunteer leaders engaging in such activities while wearing their 501(c)(3)“hat”)
- Taxation of unrelated business income (“UBIT”); same rules as for most categories of tax-exempt organizations; most common form is advertising income
- Often allows for state and local sales/use and property tax exemption; if a 501(c)(3) has a state sales/use tax exemption certificate, it only relates to the payment of sales/use tax on purchases, not to the collection and remittance of sales/use tax on sales, and only applies to purchases in that state (not elsewhere)

Antitrust Basics

- Most countries use the term “competition law” rather than antitrust like we use in the United States
- Basic idea – prevent companies or groups of companies from obtaining the power to control a market through means other than competition on the merits
  - Generally, not a violation to exercise that power
  - Nothing wrong with winning by innovating or running a better business

Basics – Different Types of Antitrust Laws

- Agreements and other coordinated and multilateral conduct – Section 1 of the Sherman Antitrust Act and Section 5 of the Federal Trade Commission Act (and comparable state antitrust laws)
  - Most of the issues for associations relate to these laws
- Monopolization – Section 2 of the Sherman Antitrust Act
- Mergers – the Clayton Antitrust Act

Basics – Agreements and Coordinated Conduct

Sherman Antitrust Act §1:

"Every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal."

"Every contract, combination in form of trust or otherwise, or conspiracy,…":

- This means *agreements*
- Often it is hard to show that there is an agreement – companies generally don't enter into formal agreements to fix prices

Proof of Agreement

- Actions of an association are often taken as evidence of an agreement among the members of the association to take that action
- Even actions of an individual working for the association can be evidence of an agreement among the members to the association

Basics – Agreements and Conduct

"…in restraint of trade or commerce…"

Does the agreement harm competition – two types of potentially anticompetitive agreements:

- Those that are deemed to be anticompetitive on their face – *per se* illegal agreements
- Those that might be anticompetitive but that must be analyzed under the "rule of reason"

Basics – *Per Se* Illegal Agreements

Per se illegal agreements

These are agreements that always or almost always restrict competition and reduce output

- Price fixing – including components of price and price-related terms like discounts, credit terms and trade-in allowances
- Market allocation – where companies agree to stay out of each others' markets so they don't compete
- Bid rigging – where the parties agree to not bid against each other
- Some group boycotts – competitors get together to enforce a price fixing agreement or harm a rival
- Some exclusive dealing arrangements (but not most; most are analyzed under the rule of reason)

Basics – Criminal Violations

- *Per se* violations like price fixing, market allocation, and bid rigging can be crimes, leading to jail time for those found guilty
- Associations have been used as cover for criminal antitrust violations
  - Lysine price-fixing cartel created a subcommittee of the European Feed Additives Association as a pretext for meeting at association meetings to fix prices
- Penalties are severe
  - Incarceration
  - Fines of up to $1 million for individuals and $100 million for organizations
- Evidence of criminal violation needs to be reported to the responsible officer of the association immediately

Basics – Agreements and Coordinated Conduct

Rule of Reason – a more-or-less detailed look at the restraint to see if it, on balance, promotes competition or suppresses competition:

- Look at the restraint itself
- Look at the market power of the companies imposing the restraint
- Look at potential efficiency justifications for the restraint

Associations and Group Boycotts

- Group boycott issues can come up in a number of ways for associations (more about each later):
  - Self-regulation and codes of ethics
  - Standard-setting, certification and accreditation programs
  - Membership requirements and access to association services and activities
- Might be illegal *per se* or may be looked at under the rule of reason

Association Antitrust Liability – General

- Where the association directly violates the Sherman Act – negotiating prices on behalf of members
- Member violates the antitrust laws through the machinery of the association which doesn't have safeguards to prevent it
  - *Hydrolevel v. American Society of Mechanical Engineers* – members in leadership positions use their positions to harm competitor in the market by interpreting safety standards; apparent authority doctrine

Antitrust Liability for Association Officers and Directors

- There **should not** be personal liability for those who exercise ordinary and reasonable care in the performance of their duties, showing honesty and good faith

- There **may be** personal liability for those who participate in or knowingly approve of an antitrust violation.

Application of Antitrust Law to Associations

- Discussions at meetings
- Membership requirements and expulsion/denial of membership
- Services to members and non-members
- Statistical reporting and information exchanges
- Standard-setting, certification and accreditation programs
- Regulation of member conduct
- Association-sponsored online forums for member communication
- Lobbying (generally exempt from antitrust liability)
- Antitrust compliance programs

Discussions at Meetings

- Proof of an anticompetitive agreement can start with proof of parallel conduct plus potentially illicit communications between rivals
  - Because association meetings generally involve communications between rivals, care must be taken to avoid illicit communications
- That means that discussions at meetings are often formalized and laid out ahead of time to a great extent

Discussions at Meetings

- Agendas and presentations prepared and distributed in advance of meetings
- Antitrust guidance at the outset of meetings or calls
- Care should be taken to keep to these materials at the meeting unless there is a good reason to depart
- Minutes of the meetings should be prepared that concisely reflect the discussions
  - Especially where they diverge from the pre-prepared materials

Discussions at Meetings

- There are a number of off-limit topics where discussions could lead to illegal agreements
  - Pricing, including any discussions of methods, strategies, timing, discounts, advertising, or what constitutes a fair or reasonable price
  - Whether to do business with suppliers, customers or competitors
  - Complaints about business practices of other companies
  - Confidential company plans regarding output decisions or decisions regarding future offerings

Statistical Reporting and Information Exchanges

- There can be *per se* and rule of reason violations as a result of information collection and dissemination
- Recall that *per se* violations include, among other violations:
  - Price fixing
  - Agreements to restrict output
  - Market allocation

Statistical Reporting and Information Exchanges

- These types of communications within an industry are often done through third parties (e.g., associations) to avoid direct contact between rivals
- Important issues for an association when acting as a third party for communications
  - Type of information (price v. cost, current v. older, specific as to parties and transactions v. more general and aggregated, only for sellers v. available to customers also)
  - Purpose of the information reporting – can't be for anticompetitive reasons
- Can you articulate pro-competitive reasons for the reporting?

Statistical Reporting and Information Exchanges

- Safe harbor: Make sure that companies can't derive info about their competitors from the disclosures
  - Aggregate info rather than individual company data
  - Older data rather than current or forward-looking data (at least three months' old)
  - Only where there is enough companies that it is hard to determine who did what
- Where there are only a few companies in the industry, it might be easy to pick out their data from the distributed information
- Have a third party (like an industry association) manage the process
- Avoid unregulated discussions of the results

Membership Requirements and Expulsion/Denial of Membership

- These are looked at as potential group boycotts
- Rules and decisions on membership and expulsion are generally considered under the rule of reason not *per se*
- Exception:
  - The rule or decision relates to access to some business input that is essential for effective competition, and
  - There are no plausible justifications stemming from the association's pro-competitive purposes.

Membership Requirements and Expulsion/Denial of Membership

- Under the rule of reason, we look to see the effect of the requirement or decision
- A number of factors depending on the case
  - Are the rules objective and consistently applied?
  - If the rules are subjective, is there a legitimate reason for the rule based on the pro-competitive needs of the association?
  - Is due process given to those expelled or denied membership?
- Notice and opportunity to respond
- Appeal process
- Disinterested decision-makers

Services to Members and Non-Members

- Competitive issues closely tied to the membership requirements
  - The more competitively important the services are, the more important that companies are not excluded from those services for anticompetitive reasons
  - Sometimes the courts decide that the service should be provided to non-members rather than requiring that the non-members should be allowed to join the association
- Rule of reason analysis generally applies

Services to Members and Non-Members

- Some general guidelines:
  - Take a look at the services that the association provides periodically to see if any are essential for effective competition by companies in the industry
  - Make sure that services like that are made available to non-members or if not that there is a good reason, tied to the benefits the association provides to members
  - There can be a higher fee for non-members than for members, but the fee should be related to the cost for providing those services to non-members
  - The antitrust risk varies based on how essential/valuable the services are in order for companies to be able to effectively compete in the industry

Service to Members and Non-Members – Trade Shows

- Access to association trade shows
  - Rules of reason analysis generally
  - Important questions and issues:
    - Are the rules objective and reasonable, and objectively and consistently applied?
    - How important is the trade show to competition in the market?
    - Is there is limited room?
      - replacing one company with another is not likely to have an impact on competition
    - Why was the company excluded? – don't exclude a company for competitive reasons
    - Similar rules apply to decisions relating to allocating space or location on the trade show floor

Service to Members and Non-Members – Trade Shows

- Some “don’ts”:
  - Don’t apply rules in a discriminatory, inconsistent or subjective manner
  - Don’t base decisions on whether the company engages in competitive pricing
  - Don’t condition decisions on whether a company agrees to not appear at a competing trade show
  - Generally, don’t use subjective criteria for participation or allocation of resources

Standard-Setting – General

- Two broad types of association standards
  - Health and Safety – Industry gets together as experts to figure out best practices for consumer health or safety
    - Example: fire safety for building materials standards from the National Fire Protection Association
  - Compatibility – members of a variety of related industries get together to develop a standard that will make sure that their products work together
    - Example: Wall outlets and plugs on electrical devices – different companies make the different devices but they have to work together
- Sometimes association standards are adopted as law or regulation by federal, state or local governments, and sometimes they are merely promulgated and made available by the association

Standard-Setting – Health and Safety Standards

Guidelines:

- There should be a justification for the development of a standard at the outset
- To the extent that the standard is going to limit access to the market for some companies, that exclusion must be justified
- Avoid allowing the process to be dominated by economically interested parties
- Ensure that all parties with a stake in the standard have an opportunity to participate meaningfully in the process
- If possible, avoid any concerted efforts to enforce the standard

Standard-Setting – Compatibility Standards

- Some of the same rules apply:
  - To the extent that the standard is going to limit access to the market for some companies, that exclusion must be justified
  - Avoid allowing the process to be dominated by economically interested parties
  - Ensure that all parties with a stake in the standard have an opportunity to participate meaningfully in the process

Standard-Setting – Compatibility Standards

Sherman Antitrust Act §2:

"Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, shall be deemed guilty of a felony…"

- DOJ can bring civil suits to enjoin monopolization
- FTC also can stop this conduct

Standard-Setting – Compatibility Standards

- Patent policies should be clear, consistently enforced and regularly announced
  - When should there be disclosure of patent rights/applications?
  - What should be disclosed (patent applications or just patents)?
  - Is there a requirement to search a member's patent portfolio?
  - What sort of commitments are required by the patent holder, if any, after disclosure?
    - RAND/FRAND
    - License negotiations
    - Disclosure of most onerous terms
    - License offer

Certification and Accreditation Programs

- Certification and accreditation programs can determine whether products comply with a standard, or whether professionals have sufficient ability, education and experience, or whether companies have sufficient expertise and experience
- Not certifying or de-certifying a product or a professional, or not accrediting a company, can create competitive harm
- Courts look at the process of how a certification or accreditation program is implemented to ascertain whether they help customers or are a way to harm rivals

Certification and Accreditation Programs

- Some factors:
  - Who are the decision-makers – competitors or customers or a mix?
  - Are the criteria objective and related to the function being certified?
  - Were the criteria applied consistently and objectively?
  - Were the association's procedures followed?
- Important to the extent that it might show that a refusal to certify was due to anticompetitive goals

Regulation of Member Conduct

- Many associations have codes of ethics/conduct regulating various aspects of the businesses of the members of the association
- This sort of regulation can be beneficial and pro-competitive
  - Industry members themselves often have the best incentives and the knowledge to maintain the reputation of the industry
  - Can improve the services offered to consumers and improve the truthfulness of advertising, for example

Regulation of Member Conduct

- A code of ethics/conduct also can be anticompetitive
  - Restrictions on truthful advertising, especially relating to price
  - Restrictions on competitive bidding
  - Restrictions on the business hours of members
  - Restrictions on business relationships with suppliers or competitors
  - Restrictions on fees or output set by members
- This type of conduct is often viewed by the courts under an intermediate level of rule-of-reason scrutiny

Association-Sponsored Online Forums for Member Communication

- Concern that competitors can use these to violate the antitrust laws in the same way they could at meetings
  - Rules regarding off-limit discussions – and other acceptable and non-acceptable behavior/discussions – on the forum should be clearly laid out, agreed to (click-and-accept) by each participant prior to joining, and sent out to all forum participants each year
  - The boards should be monitored by well-trained and responsible association staff
  - The staff should be able to (and should) promptly take corrective action when inappropriate messages are posted

Lobbying and the Antitrust Laws

- In general, petitioning the government cannot form the basis of an antitrust violation based on the effect of the petition succeeding; rooted in the First Amendment
  - E.g., lobbying a legislature or agency to get that body to pass a law that would block the entry of a competitor is shielded from liability under the *Noerr-Pennington* doctrine
- But if the petitioning is a sham and itself (rather than the government policy) has an anticompetitive impact, then that can form the basis of an antitrust violation

Antitrust Compliance Programs

- Antitrust compliance policies have become mandatory for associations
  - Absence of such a policy is viewed as poor business practice and may increase penalties for any violations that occur
  - Antitrust policies can have an antitrust-beneficial effect on the behavior of members
- Examples of responsible antitrust practices:
  - Board adopts and affirms antitrust compliance policy
  - Included in all Board books
  - Antitrust compliance statement read at start of Board meetings and committee meetings with antitrust-sensitive agenda items
  - Legal counsel attendance at meeting with antitrust-sensitive agenda items
  - Legal counsel review of antitrust-sensitive documents, programs and activities

Questions?

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