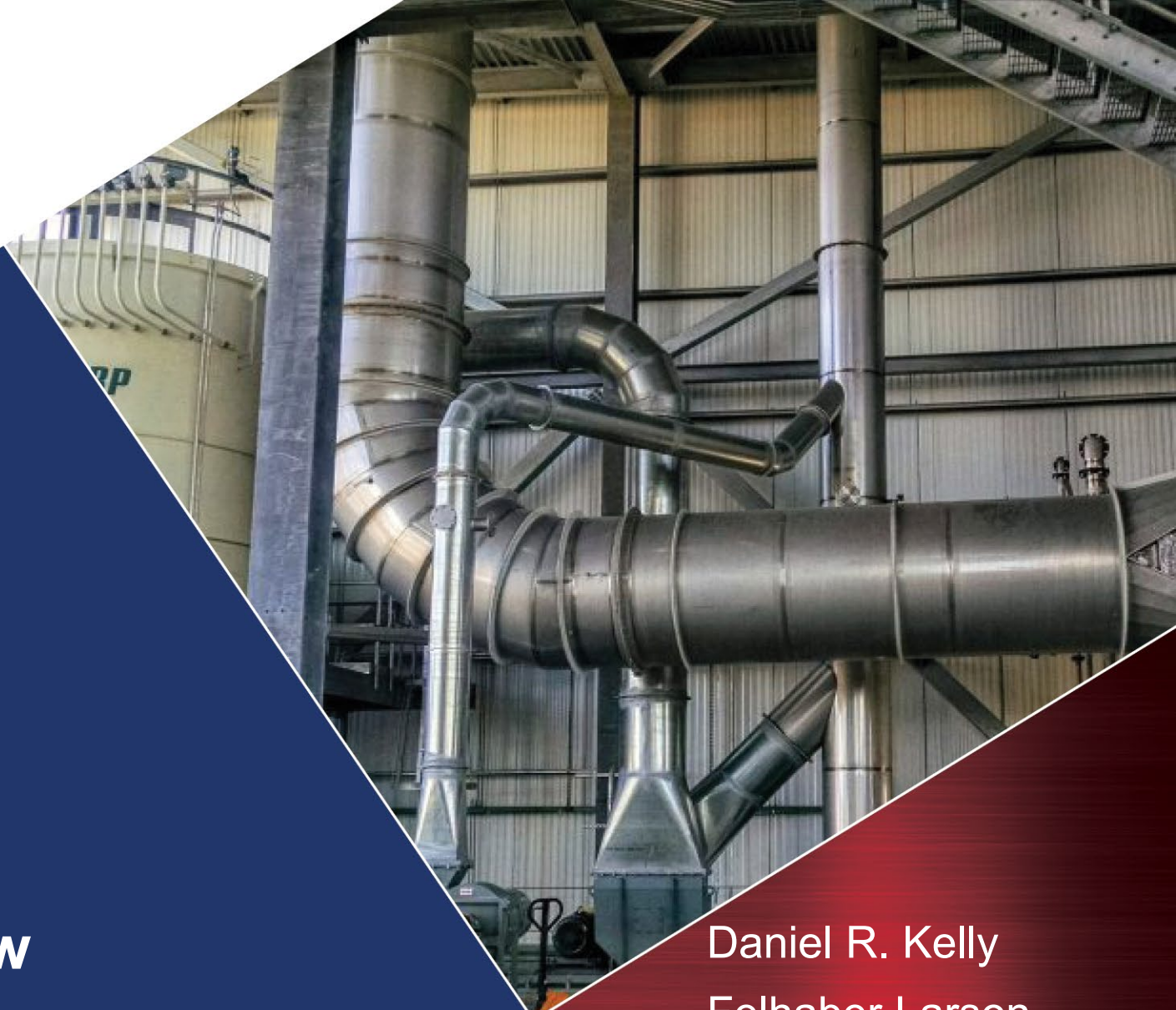




SHEET METAL & AIR CONDITIONING
CONTRACTORS' NATIONAL ASSOCIATION



2023 Trade Association Law

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Agenda

- State Law – Nonprofit
- Federal Law – IRC 501(c)6
- Inurement
- Antitrust



Trade Association

- A nonprofit organization made up of a collection of companies and/or individuals with common interests or who work in the same industry.



State Law – Nonprofit Corporation

- Typically, a trade organization is an entity formed under the non-profit or not-for-profit statute within a specific state.
- Need not be the state in which the corporation is headquartered.
- Governing documents (bylaws) must conform to state law.
- Voting procedures must comply with state law.
- Organization must comply with state law filing requirements.
- Typically any nonprofit is overseen by a state official (i.e. attorney general).
- Oversight by state official (i.e. attorney general).



Fiduciary Duties

- Under state common law and state statute, officers and directors owe the entity a fiduciary duty when running the organization.



Fiduciary Duty

- Fiduciary duty: a duty to act with the highest degree of honesty and loyalty toward another person and in the best interests of the other person



Three Primary Fiduciary Duties

1. Duty of Care
2. Duty of Loyalty
3. Duty of Obedience



Duty of Care

- Statutorily: Directors must discharge their duties “***with the care an ordinarily prudent person in a like position would exercise under similar circumstances.***”
- Generally: requires directors be ***informed, participate in governance, and ask questions***
 - e.g., regularly review the organization’s financial documents, attend board meetings, etc.



Duty of Care

- Remember: the duty of care applies to ***every decision*** every officer and director makes on behalf of the organization.



Duty of Loyalty & Obedience

- Statutorily: “Directors . . . shall discharge the duties of their respective positions *in good faith*”
- Good faith:
 1. Duty of Loyalty
 2. Duty of Obedience



Duty of Loyalty

- Generally: the duty to act in the ***best interests*** of the organization at all times
- Board members **cannot** use information obtained as a member for personal gain:
 - No self-dealing
 - No usurping corporate opportunity
 - Disclose any and all conflicts of interest or potential conflicts



Duty of Obedience

- Generally: the duty to carry out instructions and abide by restrictions on behavior
 - *i.e.*, Ensure the organization complies with applicable laws and regulations, its mission, and its internal governance policies
- Also requires board members be faithful to the organization's mission and purpose
 - *i.e.*, cannot act in a way that is inconsistent with the central purpose/goals of the organization
 - Must comply with policies regarding code of conduct and behavior



Discharge of Fiduciary Duties

In discharging duties in good faith, directors may rely on information, opinions, reports or statements presented by:

- (1) officers or employees of the organization;
- (2) the organization's legal counsel, public accountants, or other persons as to matters reasonably believed to be within such person's professional or expert competence; or
- (3) a committee of the organization board upon which a director does not serve, as to matters within its designated authority, reasonably believed to merit confidence



Discharge of Fiduciary Duties

A director “***shall not*** be considered to be acting ***in good faith*** if they have knowledge concerning the matter in question that would cause such reliance to be unwarranted.”

- *i.e.*, directors cannot rely on things they know to be untrue, misleading, etc.



Apparent Authority

- Authority imputed to an agent by law although no actual authority has been conferred by the principal
- Apparent authority exists where:
 - 1) Words or conduct of the organization or the Board (*i.e.*, the principal),
 - 2) That are communicated to a third party,
 - 3) Give rise to the reasonable appearance and belief that an officer or director (*i.e.*, an agent) possesses authority to enter into a transaction



Apparent Authority

- In effect, apparent authority may bind the organization (the principal) to actions taken by an officer or director (an agents) of the organization
 - This includes actions (both good or bad) taken beyond the scope of an officer or director's actual authority
- For example, a New York Court found that the chairman of the board of directors of a corporation (who was not the CEO) had apparent authority to pledge the credit of the corporation by obtaining an American Express credit card for himself in the name of the corporation



Board Responsibilities

1. Organization Governance
2. Strategic Planning and Management
3. Financial Management and Oversight



Organization Governance

- General management of the organization (*i.e.*, establish and administer its internal policies)
- Ensure the organization is operating in compliance with all applicable laws and regulations
- Create, adopt, and oversee compliance of required policies (*e.g.*, conflict of interest, whistleblower)
- Conduct regular and annual meetings



Organization Governance

- Add/remove directors; Hire/fire officers and employees
- Annual review of CEO
- Engage auditors, legal counsel, and other professionals as appropriate (e.g., preparation of financial statements, litigation, etc.)
- Create and manage committees of Board of Directors



Strategic Planning and Management

- Set and approve the organization 's mission and vision
- Establish and approve organizational values, goals, etc.
- Ensure the organization carries out mission and purpose
- Ensure the organization does not engage in activities outside of its mission and purpose
- Set and approve operational/annual plans



Strategic Planning and Management

- Promote positive public image of the organization
- Set and track strategic plan progress milestones
- Periodic review of the organization structure, procedure, programs, vision, goals, etc.



Financial Management and Oversight

- Establish, approve, and review annual budget
- Ensure adequate financial resources
- Regularly review the organization 's financial reports



Financial Management and Oversight

- Ensure filing of required annual financial reports
 - *e.g.*, annual Form 990 filed with the IRS
- Ensure payment of required taxes
 - *e.g.*, Social Security, income tax withholding (federal, state and local), unrelated business income tax



Federal Tax Law

IRC § 501(c)(6)

- Grants tax exemption to: “Business leagues ... not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.”



Inurement Prohibition

- In order to meet the requirements of IRC § 501(c)(6) and the IRS regulations thereunder, ***no part*** of an Association or Industry Fund's net earnings may inure to the benefit of any ***private shareholder or individual***.



Inurement Defined

- No exact definition.
- “Inurement is likely to arise where the financial benefit represents a transfer of the organization's financial resources to an individual solely by virtue of the individual's relationship with the organization, and without regard to accomplishing exempt purposes.” G.C.M 38459 (July 31, 1980).



What is an Industry Fund?

A legal entity tax exempt under IRC 501(c)(6)

Established to conduct activities benefiting the entire industry

Supported by hourly contributions mandated by a collective bargaining agreement



How Should an Industry Fund be Structured?

- The industry fund should be established as a trust
- It should have separate legal existence from the Association, which should also be a not for profit organization that is tax exempt under IRC 501(c)(6)



Permissible Expenditures

- (a) To establish, conduct or participate in such educational programs for employers and employees in the sheet metal and air conditioning industry, and the general public, with respect to techniques, ideas and methods, which will improve the industry and increase the contribution that the industry can make to the community;
- (b) To formulate programs which will promote harmony between the employers and the employees in the industry so as to avoid the possibility of work stoppages and labor disputes;
- (c) To study and institute programs which will make it possible for the industry to be of greater service to the public;
- (d) To engage in such public relations, education and advertising programs as are necessary to develop and increase consumer demand so as to maintain maximum job opportunities and steady business activity;
- (e) To establish standards within the local industry and improve such standards whenever necessary to keep pace with new developments in the industry, including but not limited to, the development of codes on a local, state and national basis;
- (f) To negotiate the terms to be incorporated in the local collective bargaining agreements and addenda thereto; and to facilitate the processing of grievances;
- (g) To engage in any proper and legal activity which will increase the efficiency of the local industry and foster good public relations;
- (h) To determine the hourly contribution to be made to the Fund by employers; and
- (i) To pay into another industry fund within the Sheet Metal Industry, provided such other industry fund has received a determination letter from the Internal Revenue Service that it is exempt from taxation pursuant to Section 501(c)(6) of the Internal Revenue Code, and provided further that its purposes and the purpose for which it will use such monies are consistent with the purposes of this Fund.



Impermissible Expenditures

- Furnish benefits for some members at special rates at the expense of other members.
- Use its funds to provide financial assistance and welfare benefits for members.
- Pay to defend members in litigation resulting from the operation of their businesses.
- Distribute earnings to members.
- Provide services to members for less than non-members where the benefit exceeds the member support for the services.
- Advertising including specific names of members or member products.



Impermissible Expenditures

- Operate an emergency loan plan or insurance plan for the benefit of members.
- Provide administrative services for the direct benefit of members.



Budgeting and Funding Association Programs

- Fact Pattern

On a monthly basis all of the industry fund contributions are transferred to the association to provide financial support, including payment of overhead expenses, and put on programs and support initiatives.



Budgeting and Funding Association Programs

Questions?

1. Is this the proper method to do this?
2. What are best practices for establishing a budget and providing financial support to the association?



Collecting Contributions

- Fact Pattern

A contractor that is signatory to the association agreement, and a member of the association, is failing and refusing to pay industry fund contributions. He is current on his fringe fund contributions, so we know it is not a circumstance where he is in financial trouble. In discussions the contractor has made it clear he has no intention of paying industry fund contributions.



Collecting Contributions

Questions?

1. What steps should we take?
2. Is it financially prudent to initiate litigation?



Antitrust Considerations

- National Elec. Contractors Ass'n, Inc. v. National Constructors Ass'n, 678 F.2d 492 (1982)



Membership Restrictions – Generally

- Trade Associations offer many services that benefit its members
 - Advertising, information sharing, certifications, product testing and research, trade shows, etc.
- These services may confer a competitive advantage upon association members as compared to non-members
- When a trade association denies membership to non-members, the trade association's actions may give rise to antitrust concerns
- SCOTUS: Trade associations cannot adopt membership rules where the purpose or effect is to suppress competition



Relevant Authority

- Federal antitrust statutes relevant to association membership restrictions are:
 - Sherman Act (15 U.S.C. § 1 *et seq.*)
 - Federal Trade Commission Act (15 U.S.C. § 41 *et seq.*)
 - Prohibit contracts, agreements, and conduct that unreasonably restrain trade
- Must also consider common law
- Antitrust Enforcement Agencies: U.S. Department of Justice and the Federal Trade Commission
- Possibility of significant civil and criminal penalties for violations



Test to Determine Legality

- Per Se
 - Certain agreements and practices are deemed illegal per se (i.e., anticompetitive on their face)
 - e.g., price fixing, market allocation, bid rigging, group boycotts
- Rule of Reason
 - Most trade association conduct, including membership restrictions, are analyzed under this test
 - Examines the totality of the circumstances to determine the likely overall effect on competition (i.e., does it illegally suppress competition?)
 - Weighs benefits of the conduct vs. the potential anticompetitive harm



Rule of Reason and Membership Restrictions

- Under the rule of reason, courts will determine whether membership restriction violates antitrust law based on an examination of the following two questions:
 - Whether exclusion of the non-member(s) will lead to an anticompetitive effect; and
 - Whether the membership requirements are reasonably necessary to achieve procompetitive benefits that outweigh the alleged anticompetitive harms
- The greater the competitive benefit from membership restriction, the greater risk of antitrust liability



Rule of Reason and Membership Restrictions

- Other important considerations:
 - Whether the membership rules are objective? If their membership rules are subjective, is there a legitimate reason based on the procompetitive needs of the Trade Association?
 - Whether the membership rules are consistently applied?
 - Whether due process is provided to members who are expelled from or denied membership?
 - (i) notice of a potential adverse decision; (ii) opportunity to respond; (iii) opportunity to appeal, and (iv) disinterested decision-makers
 - Demonstrating that an applicant received due process may provide persuasive evidence that an exclusion for or denial of membership was based on a legitimate policy of the Trade Association



Membership Restrictions that May be Permitted

Examples of membership restrictions that may be permitted under antitrust laws :

- Membership Qualifications – i.e., restricting membership based on geographic location, type of service/product provided, etc.
 - Criteria should be objective, clearly articulated, applied consistently, and related to the Trade Associations' procompetitive function or purpose. Subjective criteria should be minimized/eliminated.
- Code of Ethics – i.e., restricting membership to prevent immoral/unethical behavior
 - BUT, should ensure that these restrictions are tied to a procompetitive purpose
 - Note that these types of restrictions generally receive greater scrutiny
- Restricting Access to Services Provided by the Trade Association
 - If the Association has invested time/resources to develop the services, more likely to be permitted (unless the restrictions effectively result in preventing competition from non-members)
 - If the service is essential for non-members, it is recommended the Trade Association give non-members access to the service without requiring them to be members



Membership Restrictions that May Violate Antitrust Law

Examples of membership restrictions have been found to violate antitrust laws:

- Denying a benefit to nonmembers that significantly affects the ability of nonmembers to compete with members of the Trade Association
 - e.g., denying membership to applicants that do business with a “disfavored” supplier or customer
- Unreasonably restricting competition among members of the Trade Association
- Restrictions that are not narrowly tailored to accomplish the procompetitive needs of the Trade Association



Case Example

United States v. Realty Multi-List, Inc., 629 F.2d 1351, 1374 (5th Cir. 1980)

- Involved a listing service whose members constituted the majority of the active residential real estate brokers in the county (had over 45–member firms with approximately 400 sales associates)
- The Court concluded that the listing service’s membership criteria to be facially unreasonable because it created restraints on commerce that were not justified by its competitive needs
- The Court, in applying the rule of reason, found:
 - Requirement that members have favorable credit report and business reputation was not sufficiently defined and was not narrowly tailored to accomplish the legitimate goals of the listing service
 - Requirement that members maintain customary business hours was not justified by the need to prevent brokers from selling or giving away the confidential information supplied by the listing service
 - Requirement that members pay a \$1,000 fee for a share of stock was not justified by the competitive needs of the listing service



Mitigating Risks of Antitrust Liability for Membership Restrictions

- Do not condition membership in the Trade Association on a requirement that affects a members' ability to compete with other members
- Create, maintain, and consistently apply a policy that clearly explains the criteria for membership in the Trade Association
 - Ensure the membership policy provides due process to members who are expelled from membership or applicants that are denied membership
- Consider and document the reasons for excluding a member or denying benefits to a non-member
 - Potentially legitimate: limiting membership to providers of a particular product, service, or function, or to provider of a particular geographic area
 - Illegitimate: disadvantaging competitors of one or more members, or preventing new competitors from entering into a market



Questions?