Association TRENDS
2015 LEGAL REVIEW
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ASSOCIATION LEGAL ISSUES FROM THE PAST YEAR

By George E. Constantine and Jeffrey S. Tenenbaum

FROM THE INTERNAL REVENUE SERVICE TO THE Federal Trade Commission to state and federal labor agencies, federal and state regulators are taking a close look at association activities in 2015. In light of changes to the law and enhanced enforcement efforts, association executives should take a close look at existing policies, procedures and practices regarding employment, member discipline, and tax compliance to minimize their associations' legal and tax risks in these areas.

Below are five key legal developments over the past year for association executives to keep in mind when evaluating legal and tax compliance efforts in the months ahead:

1. Association membership restrictions and antitrust

The FTC has been looking closely at association rules governing member activities, particularly those that regulate conduct related to members' competition with one another. Most recently, the agency announced consent orders on Dec. 23, 2014, requiring the Professional Lighting and Sign Management Companies of America and the Professional Skaters Association to eliminate their bylaws provisions that limited competition among each association's members. These orders, along with two similar actions earlier in 2014 involving the California Association of Legal Support Professionals and the Music Teachers National Association, are important reminders that trade and professional association codes of ethics and membership restrictions can present significant antitrust risk if not structured properly.

PLASMA, an association representing about 25 member firms that specialize in commercial lighting, and electrical sign installation and maintenance, had bylaws provisions that, according to the FTC:

- Prohibited members from providing services in the designated territory of another member, unless the other member first declines to perform the work;
- Included a price schedule for any work performed in the designated territory of another member; and
- Barred any member, for one year following termination of membership, from soliciting or competing for the customers (or prospective customers) of another member.

Although the FTC challenged the first provision, the proposed consent order does not prohibit PLASMA from requesting that its members identify any geographic region(s) within which the members can quickly respond for service, so long as there are no restrictions on the number of members that may identify a particular geographic region as a "quick response" region.

In the PSA matter, the FTC raised similar concerns regarding a "no-solicitation" provision prohibiting member coaches from soliciting business from skaters who are signed onto other coaches.

The FTC's actions regarding these associations show a strong focus on activities that may restrict competition and, thus, in the eyes of the FTC, have an effect of causing prices to be artificially high. Associations should pay close attention to existing bylaws, codes of ethics, and other membership restrictions that seek to address competitive conduct such as advertis-

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Associations: Break some trademark rules!

By Andrew D. Price and Justin E. Pierce

UNDER THE TRADITIONAL RULES OF PROPER trademark use, brands must be used as adjectives and in a consistent manner. While this standard works for many brands, it is too restrictive when it comes to strong brands. Nonprofits with strong brands, especially famous ones, may break these rules when their culture, tradition and policy allow.

Recent trends suggest there are ways strong brands can use their marks as a noun or verb without substantial risk of genericide (i.e., when use of the term becomes so prevalent it is no longer uniquely tied to the brand-owning organization). A number of organizations have used their key trademarks as verbs in advertising campaigns without genericide. In recent months, for example, Google launched its advertising campaign "Play your heart out" to entice consumers to visit its PLAY store online.

To mitigate risk of genericide, we suggest that nonprofits take a few precautionary steps, such as:

- **Make clear to consumers** that the action suggested by the verbed-up brand use cannot be accomplished without using the branded product or service – the verbed-up brand can be built into taglines, slogans, and/or logos that reinforce this point;
- **Register the verbed-up brand** or the tagline, slogan, or logo containing the verbed-up brand; and
- **Monitor the public's use** and view of the verbed-up brand – ultimately, it is the consuming public that determines, through its use, whether a verbed-up brand has lost distinctiveness through genericide.

Next, traditional thinking says that a mark should be represented in a consistent manner. Brand owners fear the loss of rights that can occur when they cannot "tack" rights from an updated version of a mark onto rights from the original mark. Google did something disruptive when it started to morph its Google logo on a regular basis into so-called Doodles. The Doodles have enhanced goodwill in the Google brand by making it come to life in the eyes of consumers, and Google has conditioned consumers to believe that strong brands can change.

To mitigate risk, we suggest that nonprofits take a few precautionary steps, such as:

- **Make sure the subject design** or stylization has substantial goodwill;
- **Gauge how much to play** with the design

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ing, solicitations, bids, market allocation, and, of course, pricing. Such restrictions very well may give rise to significant antitrust risk.

2. New state employment laws

In recent months, states have been quite active in enacting statutes that affect all employers in their jurisdictions, including associations, and may require changes to existing policies. For instance, the District of Columbia recently became the 14th jurisdiction to enact a law that prohibits employers from asking applicants if they have ever been arrested. This "ban the box" law would permit an employer only to seek information about prior criminal convictions (not merely arrests) after it makes a conditional offer of employment to the individual. If an employer discovers a criminal conviction after the conditional offer is made, that conditional offer may only be revoked in narrow situations having to do with, for example, the nature of the conviction and its relation to the applicable position.

Also in the nation's capital, the D.C. Wage Theft Protection Act was passed recently to require numerous notices to employees, increase penalties for employers who retaliate against employees who report labor violations, and revise record-keeping procedures. The new law has been the source of much confusion among D.C. employees and, in fact, has twice been modified by emergency amendments. It is expected to become effective after a mandatory congressional review period concludes; as of the time of this writing, that effective date was expected to be Feb. 26, 2015.

Finally, in California, employers are now required to guarantee employees at least three paid sick days per year. The law includes requirements for notice to employees about their sick leave accrual and right to use sick leave. No accrual or carry-over is required if an employer provides the full amount of sick leave at the beginning of each year, allowing the employee to take sick leave before he or she would have otherwise accrued it.

3. Obamacare employer mandate begins

The employer mandate provisions of the Affordable Care Act began to take effect on Jan. 1, 2015. This imposes a mandate on large employers to offer minimum essential coverage to full-time employees and their dependent children (up to age 26) or pay a penalty tax. Further, if that minimum essential coverage is not affordable or does not provide minimum value, the employer also will be subject to a penalty tax. The mandate in 2015 applies to employers that have employed an average of at least 100 full-time employees (including full-time equivalent employees) on business days during the preceding calendar year. In future years, the definition of an applicable large employer will be 50 full-time employees.

Associations in the 100-plus employee range certainly should already have been reviewing their healthcare offerings in light of this new requirement; those with 50 or more employees should prepare for next year if they have not already done so.

4. New developments from the IRS

With the scandals from the IRS Exempt Organizations Division slowly fading into history, the division's new leaders have begun to implement changes to how associations and other tax-exempt organizations interact with the agency. Of note for 2015: the IRS has implemented significant cost increases for organizations seeking private letter rulings and has realigned its operations so that such letter rulings and technical advice memoranda are issued by a different office than had previously issued such documents. As a practical matter, this means that associations seeking a ruling from the IRS (for example, if the association is undertaking a new activity and wishes to know if the IRS will treat the revenue from that activity as taxable) will need to go to the Chief Counsel, an IRS office that does not work exclusively on tax-exempt matters. Notably, those associations will need to pay a $28,300 fee to the IRS to obtain such a ruling.

Other recent developments include the new availability of an IRS Form 1023-EZ application for small organizations that wish to obtain 501(c)(3) tax-exempt status recognition. This new application, introduced in July, is far less burdensome than the full form. Filers must complete an eligibility worksheet certifying, among other things, that the organization's total assets are less than $250,000 and that actual gross receipts were less than $50,000 for the past three years and are projected to remain the same or decrease over the next three years. The activities in the applications are described with codes, and no corporate documents are submitted.

In other IRS news, a federal judge on Jan. 30, 2015, handed the IRS a significant defeat in its fight against releasing IRS Form 990 information returns in a digitally readable format. The ruling will have a significant impact on the IRS as well as all tax-exempt organizations required to file the annual Form 990. Assuming this ruling is upheld or not challenged by the IRS, organizations that e-file their annual Form 990 will likely be the first to feel the effects of this ruling. With members of the public having searchable versions of the forms, it will be easier for the media and others to search the documents for red flags and other areas of concern.

5. Payroll taxes and nonprofit compliance

The Treasury Inspector General for Tax Administration published the results of a study last year highlighting rampant noncompliance among tax-exempt organizations in the area of payroll tax withholding and payment. The study found that more than 64,000 nonprofits have not paid taxes owed since 2012; of those, about 1,200 owed more than $100,000 in unpaid taxes.

Studies like this often serve as a launching point for IRS enforcement efforts. Payroll tax noncompliance may not present risk to an organization's tax-exempt status, but it can expose individual directors to penalties. Further, noncompliance in this area is viewed by the IRS as a potential indicator of noncompliance in other nonprofit activities; as such, an IRS audit of an organization suspected of not meeting its payroll tax obligations will almost certainly involve a broader review of other compliance areas. Association executives should take this time to review their compliance with withholding and related payroll matters and, in particular, should review whether they are properly treating individuals as independent contractors (versus as employees).

Nonprofits with federal awards face new Super Circular compliance

By Dismas Locaria and Melanie Jones Totman

NOW, A YEAR AFTER ITS RELEASE, NONPROFITS that receive federal awards (including federal grants and cooperative agreements) must begin implementing the new requirements of the U.S. Office of Management Budget's Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Super Circular). Through the Super Circular, an effort more than two years in the making, OMB sought to streamline eight federal regulations applicable to nonprofits and others into a single, comprehensive policy guide. Despite OMB's intent, the Super Circular notably imposes a set of regulations on the federal award community that is more akin to the heavily regulated federal procurement/contracting arena, a stark departure from the previous regime. In particular, the Super Circular materially changes how federal awards are administered, how such organizations may subaward or subcontract with federal funds, and how those awards/contracts should be monitored. A number of provisions were added to prevent and eliminate waste, fraud and abuse, including mandatory disclosure requirements and a prohibition of organizational conflicts of interest. Accordingly, the implementation of the Super Circular will have important implications for all nonprofit recipients of, and applicants for, federal awards.

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or stylization based on the strength of the mark (e.g., famous marks can be changed the most);

- **Change only the design or stylization,** not the corresponding word mark; and
- **Continue regular use and registration** of the original design or stylization.

Nonprofits should not be afraid to break the old rules of proper trademark use when it comes to strong brands, especially famous ones, when their culture, tradition, and policy allow.

Cybersecurity and antitrust: Guidance for assn-sponsored information exchanges

By Andrew E. Bigart and Jeffrey S. Tenenbaum

On Oct. 2 the U.S. Department of Justice issued a business review letter advising CyberPoint International LLC that its True Security Through Anonymous Reporting cyberintelligence data-sharing program does not raise antitrust concerns. Although focused on the company's cybersecurity service, the DOJ letter provides a helpful reminder to trade and professional associations of the need to be cognizant of and review any proposed information exchange or benchmarking program for potential antitrust risk.

Although such programs offer numerous benefits for participating industry members and the public, any association-sponsored exchange of competitively sensitive information will draw heightened antitrust scrutiny because of the risk that the sharing of information can lead to anticompetitive agreements. Below is a brief summary of the DOJ letter and recommended best practices for any trade or professional association interested in managing a similar program.

DOJ's business review letter

Under the federal Sherman Act and the Federal Trade Commission Act, information exchanges are analyzed under the rule of reason, which balances the procompetitive benefits of the conduct against the potential anticompetitive harm to determine the likely overall effect on competition. The main competitive concern with information exchanges is the potential for participating industry members to use the information exchanged to further a price-fixing or other anticompetitive conspiracy.

In reviewing CyberPoint's TruStar program, the DOJ applied the standard "rule of reason" analysis by reviewing (1) the business purpose and nature of the program, (2) the type of information shared, and (3) the safeguards implemented to minimize the risk that participants (members) will exchange competitively sensitive information. With respect to the first two points, the DOJ found that the focus of the program was procompetitive – it allows members to share accurate and timely intelligence on potential cyber threats, best practices, and remediation solutions. In addition, the TruStar program offers members a "community forum" that allows them to discuss cyber threats and collaborate on best practices. In this regard, the DOJ noted that CyberPoint had implemented procedures to obtain commitments from members that they would not share competitively sensitive information.

Thus, for all three factors, the DOJ found that the TruStar program was procompetitive and unlikely to raise antitrust concerns.

Recommended best practices for information exchanges

The DOJ business review letter, along with a prior joint DOJ/FTC statement on a similar cybersecurity proposal, reinforces that properly structured information exchanges and benchmarking programs can provide significant procompetitive benefits. To minimize potential risk, any trade or professional association seeking to develop such a program should keep the following safeguards in mind:

- **The proposed exchange should be reviewed** by antitrust counsel in advance.
- **Clearly articulate the purpose and procompetitive benefits** of the information exchange, and keep it closely focused on those criteria.
- **Participation should be voluntary,** and the program should include instructions cautioning participants on potential antitrust risk and prohibiting discussions of competitively sensitive information with other participants.
- **Participants should not be involved** in the collection or compilation of data for programs that involve the exchange of data.

In addition:

- **Any data provided by participants should be at least three months old** (no current or future information). Data should be provided by a minimum of five participants, with no individual participant's data representing more than 25% on a weighted basis.
- The trade or professional association or third party managing the program should **treat specific data provided by participating members as confidential** and not disclose it in its raw form to any other participant or third party.
- **The program should not identify the individual members** who participated in the survey/exchange.
- **Any data published should be in aggregate form only.**
- **Joint discussion and analysis of the data should be avoided.** Each participant should separately analyze the data and make independent business decisions based on the data.

Investigating nonprofit fraud, embezzlement and charitable diversions

By Edward Loya, Stephanie Montano, Doreen Martin and Jeffrey S. Tenenbaum

On Oct. 26, 2013, the Washington Post reported that from 2008 through 2012, more than 1,000 nonprofit organizations disclosed hundreds of millions of dollars in losses attributed to theft, fraud, embezzlement, and other unauthorized uses of organizational funds and assets. According to a study cited by the Post, nonprofits and religious organizations suffer one-sixth of all major embezzlements – second only to the financial services industry.

While the numbers are shocking, the underlying reasons for nonprofit susceptibility to fraud and embezzlement are easy to understand. Many nonprofits begin as underresourced organizations with a focus on mission rather than strong administrative practices. As organizations established for public benefit, nonprofits assume the people who work for them, especially senior management, are trustworthy. Often these factors result in less stringent financial controls than implemented by their for-profit counterparts.

Of course, nonprofit employees are not immune to the vulnerabilities of economic distress, including financial difficulties, overspending and even gambling. Further, high-level employees and their close associates have significant access to organizational funds and financial records, causing them to believe they can successfully commit the fraud and embezzlement, and conceal their conduct from outside scrutiny. Employees may rationalize their unlawful conduct as just compensation for lower salaries or unfair treatment, or as legitimate financial arrangements whereby the employee is simply "borrowing" money from the organization.

In light of the disturbing numbers reported by the Washington Post, Congress and numerous state attorneys general have pledged to launch investigations, and reportedly, some have. This will likely lead to even greater scrutiny by government regulators. External audits are necessary to ensure that effective financial controls and fraud prevention measures are being followed, but a standard audit is not the method by which nonprofit organizations should expect to detect fraud. The Association of Certified Fraud Examiners reports that less than 4 percent of frauds are discovered through an audit of external financial statements by an independent accounting firm.

Nonprofits may no longer elect to handle instances of fraud or embezzlement quietly to avoid unwanted attention and embarrassment. As of 2008, a larger nonprofit must publicly disclose any embezzlement or theft exceeding $250,000, 5 percent of the organization's gross receipts, or 5 percent of its total assets. A tax-exempt organization whose gross receipts are greater than or equal to $200,000 – or whose assets are greater than or equal to $500,000 – is subject to additional public disclosure requirements on its IRS Form 990 concerning the embezzlement or theft.

Nonprofit boards of directors should facilitate establishment and supervision of strong policies that support the best practices explained above. Nonprofit organizations should put policies and procedures in writing to clearly communicate the organization's stance. While the board should not micromanage the day-to-day operations of an organization with paid staff, neither should it be complacent about its fiduciary obligation to "act with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances." Periodic review of financial reports and the IRS Form 990 return, appointment of an audit committee, and hiring a strong chief staff executive who is in sync with all of these risk management measures are all actions a board can take to fulfill its duty of care and protect the charitable funds and other assets entrusted to it.

Enforceability of online terms of use

Guidance for nonprofits from a federal appeals court

By A.J. Zottola and Robert Parr

IN A RECENT DOJ BUSINESS REVIEW LETTER to STARS Alliance LLC, the U.S. Department of Justice reviewed a joint purchasing arrangement proposed by an association of several nuclear utility operators. As a starting point, the DOJ noted that the proposal likely qualified for the safety zone for collaborations that account for less than 20 percent of the relevant market. Nevertheless, the DOJ went on to conduct a rule of reason analysis to determine whether the anticompetitive effects outweighed the procompetitive benefits.

Starting with potential anticompetitive effects, the DOJ found that it was unlikely the arrangement would "restrict competition in either the upstream markets for goods and services or the downstream markets for electricity" because the STARS members were generally located in different geographic areas and did not compete against each other. At the same time, DOJ found that the arrangement had the potential for procompetitive benefits through increased efficiencies and lower costs.

Further, DOJ noted that STARS had implemented numerous safeguards to limit the potential for anticompetitive coordination among its members, including that the joint purchasing activities would be voluntary for members, that members would not discuss prices for procuring goods and services, and that STARS would require antitrust compliance training for its members.

This ruling confirms the general rule that, absent extraordinary circumstances, the enforcement agencies are unlikely to challenge an association joint purchasing program where members are not required to purchase a particular product or service, each member makes its own independent decision to participate, and there is significant competition in the relevant market.

Associations looking to implement a joint purchasing program should implement safeguards, as appropriate, to prevent members from sharing competitively sensitive information, such as downstream sale prices, the timing of price increases or purchase orders, and margins. Suggested precautionary measures include:

- **Check your association's governing documents** and evaluate its tax-exempt status to confirm that a joint purchasing program is a permissible association activity.
- **Consult with antitrust counsel** before establishing a joint purchasing program and periodically throughout the process to ensure compliance with antitrust laws.
- **Monitor the buying group's market share** in the input and output markets to stay within the safeguards set forth in the enforcement agencies' Antitrust Guidelines for Collaborations Among Competitors (e.g., 35 percent share for total purchases in the relevant input market and 20 percent share in the relevant output market).
- **The association or an independent agent should handle joint buying activity** and negotiate with suppliers on behalf of the purchasing group, or require each member to contract individually with the supplier offering a group discount.
- **The program should not impose minimum** purchasing requirements on members.
- **Participation in the joint purchasing arrangement should be available to all association members** and should not be limited by the size, type or location of a member.
- **Joint purchasing should not be used** to raise, lower or stabilize prices, or to boycott suppliers.
- **Members should not share competitively sensitive information** or enter into any agreement or understanding on prices or other competitive conduct in the downstream output market.
- **Any meetings of a joint purchasing group should have an agenda** and minutes. All discussions should be limited to the purposes of the joint purchasing group.
- **Antitrust counsel should be present at all meetings** where competitively sensitive information is discussed.

VENABLE LLP

Nonprofit Organizations Practice

With more than 600 nonprofit clients nationwide, Venable has the largest concentration of attorneys in the country providing counseling and advocacy for trade and professional associations, charities, foundations and other types of nonprofit organizations. Our clients call on us for assistance with matters of general nonprofit law and matters unique to their industries, professions, causes and issues.

As a result of our extensive experience representing nonprofit organizations, virtually no legal issue or problem is new to us. Experience with the most common and the most unusual nonprofit issues enables us to provide precise answers and workable solutions with a legal style marked by ingenuity and pragmatic judgment. Our understanding of the nature and business of nonprofits – derived not only from our legal practice, but also from our deeply rooted participation in the nonprofit community – enables us to offer broader and more useful counseling that recognizes practical management, political and business considerations. Our clients frequently remark how much they appreciate Venable's ability to serve as a "one-stop shop" for all of their legal needs. Our deep bench in virtually every legal area and issue affecting nonprofits enables us to tap into the experience required to deal with the most complex and sophisticated legal challenges.

Highly regarded by its nonprofit clients, Venable is steeped in the nuances, challenges and opportunities of nonprofit law – as well as the distinct culture, governance and politics of nonprofit organizations. Here is a partial listing of Venable's nonprofit team:

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