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Two Recent FTC Cases Demonstrate the Antitrust Risk of Association Codes of Ethics

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The Federal Trade Commission (FTC) recently entered into consent orders with the Music Teachers National Association (MTNA) and the California Association of Legal Support Professionals (CALSPPro). The consent orders highlight how trade and professional association codes of ethics can raise competitive concerns no matter the size of the association. Together, they demonstrate that codes of ethics (and other similar membership restrictions) can raise potential antitrust concerns if they limit the ability of members to compete, reduce prices, increase output, engage in truthful competitive advertising, or recruit the employees of rivals.

We provide below a brief overview of the two consent orders, highlight the relevant antitrust risks of codes of ethics, and discuss certain best practices that an association can take to minimize potential antitrust (and other) legal risks in connection with such codes. In particular, any association that is considering adopting a code of ethics should first determine what it hopes to accomplish through such a program, and then ensure that the program is designed to minimize potential legal risk.

Antitrust Risk of Association Codes of Ethics

The **Sherman Act** (15 U.S.C. § 1 *et seq.*) and the **FTC Act** (15 U.S.C § 41 *et seq.*) prohibit agreements among competitors that unreasonably restrain trade. Codes of ethics, like most association activity, are analyzed under the rule of reason, which examines the totality of the circumstances to balance the pro-competitive benefits of the conduct against the potential anticompetitive harm. *See, e.g., Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679 (1978).

Although the FTC and the U.S. Department of Justice (the primary federal antitrust enforcement agencies) recognize that association codes of ethics can serve many legitimate purposes, the agencies will scrutinize codes that directly or indirectly prevent members from competing against each other. With respect to the MTNA, for example, the FTC alleged that the association and several of its affiliates implemented codes of ethics that prohibited members from charging music lesson fees that were lower than the average in the community, offering free lessons or scholarships, or advertising free scholarships or tuition. Similarly, the FTC alleged that CALSPPro had adopted a code of ethics that prohibited its members from “offering discounted rates to rivals’ clients, engaging in certain comparative advertising, and recruiting employees of competitors without first notifying the competitor.”

In both cases, the FTC noted that the codes of ethics had “the purpose, effect, tendency, or capacity” to restrain competition. The CALSPPro code, for example, provided that “It is not ethical to cut the rates you normally and customarily charge when soliciting business from a member firm’s client” Making matters worse, both associations had established processes for resolving alleged violations of their respective codes, including the imposition of sanctions.

Further, the FTC’s consent order with the MTNA highlights a risk that is somewhat unique to associations – that an umbrella association can be held responsible for the activities of its local chapters and affiliates. Although the FTC was clearly concerned with the MTNA’s code of ethics, the FTC focused on the fact that many of the local affiliates adopted code provisions that were even more restrictive than those adopted by the umbrella organization. Thus, as part of the consent order, the FTC required the MTNA to obtain certifications from each of its roughly 500 affiliates confirming that the affiliate does not have restrictions on student or job solicitations, advertising, or price-related competition. MTNA is required to disaffiliate any affiliate that fails to provide such certification.

Suggested Best Practices to Minimize Potential Legal Risk

The FTC consent orders with the MTNA and CALSPPro highlight that the costs and burdens of defending a government antitrust investigation far outweigh the costs of implementing an antitrust compliance program. Notably, the MTNA **posted a statement on its website** explaining that signing the consent

order was better than “spending hundreds of thousands of membership dues dollars fighting the federal government.”

There are a number of important steps that an association should consider to limit potential risk when implementing a code of ethics or similar type of program. At the top of the list should be the adoption of an antitrust compliance program. The FTC consent orders with MTNA and CALSPRO require the associations to adopt such a program. The purpose of an antitrust compliance program is to ensure that all aspects of an association’s activities are vetted for potential antitrust risk by in-house or outside counsel. A formal antitrust policy should include, at a minimum, the following provisions:

- Overview of the antitrust laws and explanation of prohibited types of conduct;
- Affirmation of the association’s commitment to compliance with federal and state antitrust laws;
- Requirement for employee training and distribution of the policy to the association’s officers, directors, employees, and representatives;
- Requirement that association meetings have an agenda circulated in advance, and that minutes of all meetings properly reflect the actions taken at the meeting; and
- Requirement that any committee or staff recommendations or decisions that potentially impact the market are reviewed in advance by in-house or outside counsel.

With regard to codes of ethics and other similar restrictions on the association’s membership, the association should keep the following best practices in mind:

- Codes of ethics should never be created or used for the purpose of raising, lowering, or stabilizing prices or fees, excluding competitors from the market, or limiting the supply of products or services.
- There should be a valid, objective reason for each code provision. The association should document the development and reasonableness of the proposed code provisions. Code provisions should be no more stringent or rigid than necessary to ensure that minimum acceptable levels of conduct are met.
- The code of ethics should be reviewed and updated periodically to ensure that it is current. In addition, associations should document any and all complaints or concerns about the code of ethics and resolve such complaints or concerns as appropriate.
- A code of ethics should be clear and unambiguous, reasonable, fair, and objective. The process must be objectively and uniformly administered, without subjectivity, favoritism, or discrimination. The rules of the process must be scrupulously, consistently, and objectively followed by those administering the program. Due process should be built into the program.
- Associations should maintain strict confidentiality with respect to all adverse allegations, complaints, actions, and proceedings that arise in connection with the process.

Finally, although the MTNA and CALSPRO consent orders were based on antitrust concerns, it is important for associations to recognize that codes of ethics and other member restrictions can raise legal concerns in the areas of due process, defamation, and federal tax-exempt status. Common law due process, for example, requires associations to provide notice of potentially adverse decisions to members or prospective members, to provide an opportunity for such persons to defend themselves, and to provide an opportunity to appeal any adverse decision.

Defamation is the oral utterance or written publication of false or misleading facts, or false or misleading implied facts, that are derogatory or damaging to the reputation of an individual, entity, or product. It becomes a risk when an association uses its code of ethics to accuse members of dishonesty or other moral, professional, or business deficiency. Defamation claims may arise whenever an individual or entity is denied or expelled from membership, or when potentially damaging information about a member or applicant is disclosed during a code of ethics enforcement process.

Finally, a tax-exempt association could potentially run afoul of federal tax law prohibitions on Internal Revenue Code Section 501(c)(6) organizations providing substantial “particular services” to members if the association’s code of ethics is used primarily as a tool to resolve intra-membership business disputes. An association would only be in danger of losing its tax-exempt status if the IRS were to determine that the activity is greater than 50% of the association’s total activities. Even if this test is not met, the IRS still might seek to tax (as unrelated business income) fees received by the association in exchange for the provision of such services.

Any association that has a code of ethics, or is looking to implement one, should take steps in advance to ensure that the code serves a legitimate function and does not expose the association to potential antitrust or other legal risk. Spending some time focusing on these issues upfront can often save a lot in terms of cost and headache in the long run. After all, the costs of defending a government investigation or private lawsuit – regardless of merit – will undoubtedly far exceed the cost of vetting the proposed code of ethics or other association membership restriction for potential legal risk.

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