

## GUIDING YOUR ASSOCIATION THROUGH LEGAL THICKETS

by Malcolm D. MacArthur

*What are the advantages of incorporating an association?*

Incorporation protects association members from personal liability because the corporate entity stands as a barrier between the association's members and any person to whom the association is legally obligated. The association is liable only to the extent of its assets, not the members' assets.

In addition, an incorporated association must be sued in its own name. Individual members cannot be brought into the suit as codefendants, which is a possibility if the association is not incorporated.

*Does incorporation shield members from legal responsibility for their own wrongful acts, such as negligence?*

No. If a member engages in conduct on behalf of the association that constitutes a crime or a civil wrong such as negligence, he or she can be held legally responsible, whether or not the association is incorporated.

*What is the liability of association officers and directors?*

They are under a legal obligation to use good faith in carrying out their responsibilities. They must exercise ordinary diligence and care in doing their work on behalf of the association. Officers and directors usually will not be held personally liable merely for exercising bad judgment or for acting incompetently. Fraud or bad faith, however, could be a basis for personal liability.

In addition, officers and directors who participate in criminal acts and certain civil wrongs that injure persons or property can also be held personally liable for their conduct.

*You said officers and directors should exercise diligence in carrying out their duties. Could you be more specific?*

One of the most important things officers and

directors can do in exercising diligence is to ensure that the organization is managed by a competent chief staff executive and that the executive's performance is adequately reviewed. In addition, officers and directors should stay informed about all important association matters.

To protect themselves against the possibility of personal liability, officers and directors should attend all board and association meetings at which important business is discussed; review the bylaws, articles of incorporation, financial statements, and other significant association documents; and avoid any conflicts of interest. They should also insist that association activities with legal ramifications be closely supervised by legal counsel.

*What area of the law is most important to associations?*

For most associations, it is compliance with antitrust laws. Basically these laws prohibit concerted activity that restricts competition. The penalties for violating antitrust laws are severe—jail sentences, for example, are often imposed.

Members of most associations compete with each other, so the possibility is ever present that they may engage in conduct that limits competition in violation of antitrust laws. For this reason, association officers and board members should ensure that all their activities are conducted within safe limits under the antitrust laws.

*What items should association board minutes contain?*

In general, minutes should accurately record what was accomplished at the meeting and, to a limited extent, what was said. They should not contain comments by the recorder on what was said or done. They should show the place, date, and time of the meeting and who attended, and state that a quorum was present under the association bylaws. They should contain a state-

ment that the minutes of the previous meeting were distributed and approved, as written or with changes.

The minutes should record each motion that was made, the name of the person making the motion, and the number of votes for or against the motion. In general, the minutes should only mention the subject of reports that were made, perhaps with a brief description of them. Written reports may be attached to the minutes, along with contracts or other documents that were approved at the meeting.

*What records must an association keep for legal reasons, and how long must they be kept?*

This is a difficult question because the nature of the association record determines how long it should be retained. Some documents should be kept permanently: the association's certificate of incorporation, bylaws, annual reports, corporate election records, accounts payable ledger, tax returns, annual financial statement, trademarks and copyrights, annual meeting and board minutes, and manuals and other policy documents.

Financial and personal records should be kept for three to seven years, depending on the nature of the record. Government relations documents and membership records should be kept for two years. Correspondence and other records may be disposed of after one or two years, or when they become obsolete.

Ideally, each association should develop a detailed document-retention schedule.

*Can an association restrict certain persons or firms from becoming members? If so, under what circumstances?*

An association can impose membership restrictions under some circumstances, depending on the nature of the organization. The legal rules regarding membership in a trade or professional association are much stricter than for social or civic organizations.

*Why is that?*

Trade and professional associations usually provide their members with important commercial or professional benefits. When such associations

deny membership to firms or individuals, they deprive them of those benefits and thus impair their ability to compete. This could constitute an unreasonable restraint of trade in violation of the Sherman Antitrust Act.

On the other hand, restricting membership on civic or social organizations generally does not create antitrust problems. Since the services provided by such organizations are not commercial, denying services to firms or individuals will not put them at a competitive disadvantage.

But even social and civic organizations cannot arbitrarily restrict membership. For example, an organization that discriminates on the basis of sex or race may find its tax-exempt status challenged by the IRS or by state authorities.

*What are legitimate ways for an association to restrict its membership?*

An association has a right to define its membership qualifications in terms of the industry or profession it was established to serve. For example, most associations base eligibility on three criteria: the product or service involved, the functional level in the industry served, and the geographical area covered.

Membership requirements should be reasonable, consistent with the stated purposes of the association, and applied without discrimination. They should be stated so that no person or firm that meets the criteria is arbitrarily excluded or discriminated against.

Generally, an association must admit as members all those in the covered field whose ability to compete with members would be impaired if they were excluded from membership. If its membership criteria are reasonable, however, the association may exclude all those who don't meet them.

*Must a trade association make its services available to nonmembers?*

Generally speaking, valuable association benefits or services must be made available to all firms or persons in the industry or profession. You can't force nonmembers to join the association just to obtain those benefits.

Under the antitrust laws, it is generally unlawful to require people to buy a product or service they

do not want—membership in the association—to obtain a service they do want—the desired association benefit.

The safest approach is to make all services available to nonmembers and require them to pay the pro-rated cost of the service, taking into account that they pay no dues. In general, nonmembers can be required to pay a higher price than members are charged, but the price must be reasonable.

*When can an association expel a member?*

The association must be sure that it has reasonable grounds for expulsion and that the procedures ensure fair treatment. What is reasonable will, of course, depend on the particular case.

In most trade associations, the only grounds for termination should be non-payment of dues or the withdrawal of the firm or individuals from the industry or profession. In such cases, termination should be the automatic consequence.

When termination rests on other grounds, such as conduct not in keeping with generally accepted business standards, association leaders must ensure that the grounds are reasonable. An association may not expel a member for reasons that would be insufficient to deny membership.

To assure fairness and uniformity, grounds for expulsion should be stated in the association's bylaws. The formal procedure for expulsion should be followed in all cases and should include notice of charges, an opportunity for reply, the right to a hearing, and the right to appeal an unfavorable decision to the association's board of directors.

*Can a code of ethics be enforced?*

Attempting to enforce a code of ethics issued by an association composed of competing members generally creates antitrust problems. If any provision of the code is anticompetitive, then the code itself presents antitrust problems. For example, consider a code of ethics that prohibits competitive bidding.

Codes of ethics that are procompetitive or that promote a worthwhile purpose, such as safety or clarity in advertising, can lawfully provide sanctions, such as requiring a firm to withdraw from the program. It is also possible to refer complaints

about code violations to an appropriate government agency, such as the Federal Trade Commission.

Because many antitrust problems have arisen from codes of ethics and other forms of industry self-regulation, this subject should be closely monitored by legal counsel.

*What should be done if two association members start discussing industry prices at a meeting?*

They should immediately be admonished to stop their discussion. This is the responsibility of counsel or staff, but if neither are present, any other person should insist that the conversation be halted.

If the discussion continues, the meeting should be adjourned and everyone present should leave the room. Those who were in attendance should demand that the minutes reflect they left the room.

*What are the legal ramifications of a statistical reporting program?*

Statistical information usually includes data that are proprietary in nature and sensitive from a competitive standpoint. Accordingly, the way the information is collected and used can create problems under the antitrust laws. General guidelines for avoiding such problems are:

1. The purposes and possible uses of the statistical program should be clearly stated.
2. Participation in the program should be voluntary.
3. Nonmembers should be allowed to participate for a reasonable fee.
4. The data should focus on past transactions and should be disseminated in composite form so specific prices or individual companies are not disclosed.
5. Competitive and legal considerations should determine who receives the information.
6. Counsel should supervise the program.

*What are the rules regarding development of industry standards?*

Product standards may cover a product's composition, construction, dimensions, performance, or nomenclature. Because standardization programs have great competitive significance, they

can create antitrust problems unless precautions are taken.

The standards cannot be used as a means of fixing prices, boycotting suppliers, or otherwise restricting competition. The program may not discriminate against any participant or against any person or firm affected by the standard. The standard should have a reasonable purpose, should cover product performance, should not require adherence, and should be periodically reviewed and updated. In addition, all affected parties should jointly develop the standard.

*What is the difference between a trade association and a professional society? Does the government keep a closer eye on one than the other?*

The essential difference is in the kinds of members they serve. In addition, under very limited circumstances, the activities of professional societies may be exempt from antitrust laws if state authorities compel them to take certain actions. For example, a state bar association may be exempt from antitrust laws if it undertakes disciplinary proceedings because of the rules of the state supreme court.

Like trade associations, most professional associations are organized under Section 501(c)(6) of the Internal Revenue Code. Some professional associations, however, qualify for tax-exempt status as "scientific organizations" under Section 501(c)(3).

With these minor exceptions, both trade and professional associations are subject to the same laws, including tax and antitrust rules.

*What potential tax problems do non-profit associations face?*

The two most common problems are: the possibility that the association will engage in some activity that may jeopardize its tax-exempt status; and the possibility that association activities may produce unrelated-business income that is subject to federal income tax.

*Under what circumstances can an association's tax-exempt status be endangered?*

An association's tax-exempt status could be endangered if the organization does not comply with the requirements in the Internal Revenue Code

and the regulations under which it qualified for the exemption. For example, a trade or professional association that qualifies as a "business league" for exemption under IRC Section 501(c)(6) must ensure that: 1) the association consists of people who have a common business interest; 2) it is not organized for profit; 3) its activities are directed to improving conditions in one or more lines of business; 4) it is not engaged regularly in a business of a kind ordinarily carried on for profit; 5) no part of its net earnings inures to the benefit of any private shareholder or individual, including members or employees; 6) its activities are designed to improve business conditions, as opposed to performing particular services for individuals.

These criteria sound simple but are frequently difficult to apply. An easier test might be: is the organization intended and operated to promote a common business interest of association members and to improve business conditions in general, without rendering particular services or benefits to specific persons?

*You said that the other common tax problem of associations is the possibility that they may realize unrelated-business income. Would you explain that?*

The Internal Revenue Code imposes a tax, normally at corporate rates, on the net unrelated-business income of exempt organizations. There are three tests for determining whether an organization realizes unrelated-business income. The income must (1) be from a trade or business that (2) is regularly carried on and (3) is not substantially related to the functions or objectives on which the exemption is based.

The key question is whether an activity is "substantially related" to the organization's exempt function—is it an integral part of those functions? If not, and if income from the activity is relatively large, it could endanger the entire tax-exempt status of the organization. If it is relatively insignificant, the tax on unrelated-business income will be imposed but the overall tax-exempt status will be preserved.

*What association activities produce unrelated-business income?*

First of all, dues, contributions, and proceeds from the sale of goods or services produced as part of the organization's tax-exempt functions are not taxable. In addition, rents from real property, dividends, most capital gains, interest, and royalties are not subject to the unrelated-business income tax even if they meet the tests for determining the tax.

Income from insurance activities, advertising, and some kinds of debt-financed property is generally considered unrelated-business income.

*What is a subsidiary corporation, and why do associations form them?*

A subsidiary corporation is owned or controlled by a parent corporation—in this case, the association. There are two principal kinds of subsidiary corporations: profit-making subsidiaries and foundations. Profit-making subsidiaries are established to protect the association's tax-exempt status by isolating one or more of its income-producing activities in a separate entity. Such subsidiaries are fully taxable at the usual corporate rates and must be maintained separately from the association.

Foundations are usually formed by the association to ensure that tax-deductible charitable contributions can be made to finance the foundation's activities.

*What are the duties of legal counsel, and when should an association retain counsel?*

Counsel's basic function is to review the activities of the association and to recommend a legal-compliance program that fits the association's needs. In some cases, the program will consist only of giving advice when needed; in others, it may mean full-time supervision by one or more attorneys.

Antitrust compliance is usually the subject of greatest concern. In addition, an attorney may advise the organization in its dealings with government.

The scope of counsel's work is governed by the nature of the association's activities. At one extreme is a social club that meets informally a few times a year and does not often need legal advice. At the other is a large trade association that represents competitors in a basic industry such as steel or plastics and whose activities must be

closely supervised by its attorneys.

Because virtually all organizations face potential legal problems, they should all have access to lawyers who have experience in association law.

*What are the types of tax-exempt organizations?*

Provisions for tax-exempt organizations are included in Section 501 of the Internal Revenue Code. The following list presents the basic criteria for each of the six types of organizations:

*501(c)(3) Charitable, Educational, Religious, and Scientific Organizations.* This includes corporations and foundations that are organized and operated exclusively for religious, charitable, scientific, testing-for-public-safety, literary, or educational purposes, to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals. No part of a 501(c)(3) group's net earnings can inure to the benefit of any private shareholder or individual. In addition, no substantial part of its activities can carry on propaganda, attempt to influence legislation, or participate in a political campaign on behalf of a candidate for public office.

*501(c)(4) Civic Leagues, Social Welfare Organizations.* This includes civic leagues or organizations that are not organized for profit but are operated exclusively to promote social welfare. Also included are local associations of employees, the membership of which is limited to certain employees in a particular municipality. Net earnings must be devoted exclusively to charitable, educational, or recreational purposes.

*501(c)(6) Business Leagues (Trade and Professional Associations) and Chambers of Commerce.* This includes business leagues, chambers of commerce, real estate boards, boards of trade, or professional football leagues that are not organized for profit. No part of the net earnings can inure to the benefit of any private shareholder or individual. [Note: Some professional associations may qualify for an exemption under 501(c)(3).]

*501(c)(7) Social Clubs.* This includes clubs organized for pleasure, recreation, and other non-profitable purposes. Substantially all of a 501(c)(7) group's activities must be devoted to such purposes. No part of the net earnings can inure to the benefit of any private shareholder.

*501(c)(9) Employee Beneficiary Associations.* This includes voluntary employees' beneficiary associations providing for the payment of life, sickness, accident, or other benefits to the members of such an association or to their dependents or designated beneficiaries. No part of the net earnings—other than through such benefit payments—can inure to the benefit of any private shareholder or individual. This category includes many trade association insurance trusts.

*501(c)(10) Fraternal Societies Not Offering In-*

*surance to Members.* This includes domestic fraternal societies, orders, or associations that operate under the lodge system. The net earnings of a 501(c)(10) group must be devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes. The payment of life, sickness, accident, or other benefits is not allowed.

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## Abstract

DAVIDSON, HAROLD. 1985. **Woody plants can survive with good overwintering practices.** *Am. Nurseryman* 161(6): 91-95, 98, 100-101.

Periodically, winter can have disastrous effects on plants that are normally considered hardy. Late winter (March and April) is a good time to assess damage, evaluate its cause or causes, and make plans to prevent or minimize future damage. For practical purposes, winter injury to woody plants can be classified under six categories: freeze injury, frost crack, desiccation, breakage, heaving, and girdling injury. Freeze injury occurs most frequently when non-indigenous species are grown in areas where winter temperatures drop below their individual freezing points. Frost crack causes a tree trunk to split vertically. Generally, the crack appears on the tree's southwest side. Desiccation, or drying out of foliage, is a form of winter injury most commonly associated with broad-leaved evergreens. However, it also attacks narrow-leaved evergreens and deciduous species. Plant tissue dries out when there is a vapor pressure deficit between the tissue and the ambient atmosphere. The deficit is generally greatest on sunny winter days when the soil is frozen. Branches may be broken by rain that freezes on them or by the weight of snow. In northern climates, young plants and bulbs planted in fall are subject to heaving caused by alternate periods of freezing and thawing. This is especially true of material planted in clay soil. Finally, winter injury to woody plants can be caused by the depredations of animals, such as deer, rabbits, and mice.