

FTC Regulation May Extend to Charities: What Nonprofits Need to Know

Were you paying attention to the recent news about the Federal Trade Commission's (FTC) rule banning noncompetition clauses (the Rule)? You may have missed this critical point the FTC included as part of the rollout of that new Rule!

Charities Not Excluded by Class From FTC Regulation

Many theorized that nonprofit organizations exempt from taxation under Section 501(c)(3) as charitable rather than commercial endeavors (charities) were beyond the jurisdiction of the FTC by class. While this may never have been true, the Rule removed any doubt by flatly affirming otherwise. Under its authority, the FTC found that noncompetition clauses function as an unfair method of competition and, far more interesting, **refused to categorically exclude charities from the effects of the Rule (and, by implication, other FTC rules and regulations).**

Charities cannot simply assume they can ignore the mandates and requirements of the FTC. A charity must examine how it currently operates and how it may operate in the future to address whether FTC requirements are triggered. For example, with scarce resources and the constant challenge of fundraising, many charities might consider strategies to diversify or supplement revenue streams. This simple reaction to economic reality may trigger FTC limitations and requirements that could significantly impact traditional activity and create exposure not considered **or insured.**

Determining When FTC Regulations May Apply

Unfortunately, there is no single clarifying standard that charities can use to determine when FTC jurisdiction is triggered. The FTC examines each charity's unique operating circumstances to determine whether it "is organized to carry on business for its own profit or that of its members." This means, of course, that each case is a fact-specific inquiry. Charities, therefore, must undertake their own self-assessments and gauge whether their unique results create a significant risk of FTC oversight. Moreover, each time a significant change in operational strategy is considered, the same analysis will be necessary.

The "good news" is that a charity's self-assessment can be guided by the courts and the FTC's historical two-factor test when determining whether requirements apply. That inquiry requires that a charity review (1) the character of its activities, which arguably create profit, and (2) how it uses and disposes of income. Revenue and income become profit when the organization "realizes gain which will ultimately be distributed to its...members," not merely by generating more revenue than expense as required for self-perpetuation. A court or the FTC also examines whether there is "an adequate nexus...between its activities and its alleged public purposes."

Applying the Test and Wandering in the Desert

As a general matter, the closer a charity can operate to directly further its philanthropic purposes, the better situated it will be under the two-factor test. The charity's revenues should derive from activities directly related to its public purpose and function for the benefit of the organization — not as distributions to members or directors.

But what about when practical responses to operating or revenue challenges are necessary? What happens when actions are taken to retain key executives or respond to risks endangering “traditional” forms of support such as grants or third-party assistance? To the extent such activities stray beyond the organization’s public purpose and/or revenues might be viewed as distributed to the organization’s members or directors, a charity may be deemed as “carrying on business for its own profit or that of its members” and would be subject to FTC jurisdiction.

Beyond these basic points, the FTC has left charities with little to rely upon to clearly understand when they might “cross the line” and operate too much like a commercial enterprise. For example, do any of the following operating strategies on their own or collectively raise serious risks:

1. If a charity decides to retain key executives but is deemed to have overpaid or used improper incentives through bonus options, has the charity also unwittingly provided “profits” to members and thereby triggered FTC jurisdiction? What did the board’s compensation committee consider and do?
2. If a charity generates unrelated business income through other sources of revenue (such as rental income), does this similarly trigger FTC jurisdiction?
3. If a charity properly participates in a joint venture with for-profits to provide access to capital, such as a partnership or limited liability company, does this create risk?
4. Does a charity create a greater risk of regulation because it operates regularly in commercial arenas, such as trade associations, health care, and debt counseling services?

At this juncture, what we can say with certainty is that if a charity answers “yes” to any of the questions above, it might need to re-evaluate its actions or plan to comply with FTC requirements. While commercial-like activity alone may not constitute the “adequate nexus” necessary to confer FTC jurisdiction, who can effectively say when such activities become too much and create the risk that a charity is “carrying on business for its own profit or that of its members,” especially when the FTC, with its current leadership, is aggressively applying jurisdictional concepts to pursue matters?

Potential FTC Obligations

Charities whose activities and revenue distribution bring them within FTC jurisdiction will be subject to a range of rules promulgated under the power granted by the FTC Act, not just the Rule. All FTC rules addressing anticompetitive behavior and consumer protection apply to nonprofit entities subject to FTC jurisdiction, regulating interaction with donors, clients, and the general public. Rules potentially impacting nonprofit activities and operations include the:

- Telemarketing Sales Rule;
- Mail, Internet, or Telephone Order Merchandise Rule;
- Children’s Online Privacy Protection Rule (COPPA);
- Private Vocational and Distance Education Schools;
- Health Breach Notification Rule;
- CAN-SPAM Rule;
- Disposal of Consumer Report Information and Records;
- and the Guide Concerning Use of the Word “Free” and Similar Representations.

Furthermore, the FTC under this administration is likely inclined to implement new rules like the prohibition against non-competes designed to protect consumers and competition. The Rule was a product of this philosophy and likely portends the issuance of other rules. Proposed rules targeting unfair or deceptive fees, the use of consumer testimonials, and recurring charges for products or services that cannot be canceled without undue difficulty are currently progressing through the rulemaking process.

By unwittingly operating in a manner that renders a charity subject to FTC jurisdiction, you could create further operating complexity for your organization. This guidance is designed to “open your eyes” and highlight questions to ask when undertaking activities such as the diversification of revenues. By distributing net revenues or generating profit beyond what’s necessary for operation and perpetuation, whether for a charity’s benefit or the benefit of its members, you may be subjecting your organization to the unanticipated and unforeseeable regulatory requirements that arise following each Presidential election cycle.

Charities will need to examine their activities and, where appropriate, limit the potential for FTC regulation. For others, new compliance obligations may need to be considered given the risk that substantial activities likely mean FTC regulation applies. If you have questions or concerns regarding whether your nonprofit organization is subject to this Rule now or in the future, please contact [Jim Catanzaro](#) or [Mitch Barton](#) for more information.