Study B-501 May 9, 2002

First Supplement to Memorandum 2002-25

Uniform Unincorporated Nonprofit Association Act (Discussion of Issues)

The staff draft attached to Memorandum 2002-25 includes proposed Section 18025, defining "unincorporated association" for the purposes of the proposed Corporations Code provisions of the proposed law:

> "Unincorporated association" means an unincorporated organization of two or more persons joined by mutual consent for a common purpose and operating under a common name.

The principal California case discussing the meaning of the term "unincorporated association" applies a slightly different test than that stated in the proposed definition:

> The criteria applied to determine whether an entity is an unincorporated association are no more complicated than (1) a group whose members share a common purpose, and (2) who function under a common name *under circumstances where fairness requires the group be recognized as a legal entity*.

Barr v. United Methodist Church, 90 Cal. App. 3d 259, 266-67 (1979) (emphasis added).

The obvious difference is that the *Barr* criteria require consideration of fairness in determining whether a group is an unincorporated association and proposed Section 18025 does not. This supplement discusses that distinction.

Application of Definitions

The difference between proposed Section 18025 and the *Barr* criteria derives from the difference in their application. Proposed Section 18025 was drafted to govern the Corporations Code provisions of the proposed law. Those provisions are beneficial to unincorporated associations and their members, and it is unlikely that any unincorporated group would object to being subject to them. For that reason, proposed Section 18025 was drafted to apply broadly.

In *Barr*, on the other hand, the court was considering whether an unincorporated religious denomination was subject to suit under former Code of Civil Procedure Section 388(a), which provided:

> Any partnership or other unincorporated association, whether organized for profit or not, may sue and be sued in the name which it has assumed or by which it is known.

Former Section 388(a) is continued in Code of Civil Procedure Section 369.5(a).

The issue of amenability to suit casts a different light on the question of whether a group should be treated as an unincorporated association. While it is unlikely that any unincorporated group would object to laws recognizing its capacity to own property or limiting the liability of its members, groups may well object to being sued. Also, as discussed below, the question of whether to treat an unincorporated religious association as a legal entity that is subject to suit raises special problems. This may explain why the *Barr* court chose to include fairness as an element of its criteria.

Barr v. Methodist Church

In *Barr*, one of the defendants at the trial level was the United Methodist Church (UMC), an unincorporated religious denomination. The UMC asserted that it was not an unincorporated association for the purpose of former Section 388 and could not be sued. The trial court agreed, but was reversed on appeal.

It was undisputed that the UMC was an association of two or more persons with a common purpose, operating under a common name. Thus, the decisive point seems to have been the fairness of recognizing the UMC as a legal entity. Although the opinion does not use the term "fairness" in its analysis, the court's holding was clearly based on equitable principles:

> UMC, in fulfilling its commitment to society, has elected to involve itself in worldly activities by participating in many socially valuable projects. It has enjoyed the benefits, both economic and spiritual, of those projects. It has even on occasion filed suit for the protection of its interests. It must now, as part of its involvement in society, be amenable to suit.

Barr at 272.

Interference with Religious "Polity"

It has been argued that treating an unincorporated religious denomination as a legal entity may impair the free exercise of religion by imposing a corporate existence on an unincorporated denomination that is nonheirarchical.

In many cases, a religious denomination's "polity" (i.e., its form of organization) is determined in part by the denomination's spiritual doctrine. For

example, the Catholic Church is hierarchical, consistent with the special status of the papacy and a belief in a single, indivisible church. Congregational denominations, on the other hand, are nonheirarchical:

> Each member of the church is considered equal, with personal control over both his religious life and his local congregation, and the autonomy of the local church is emphasized. Although local churches in congregational denominations are not totally independent, since there is a certain amount of interaction among them, the element of control of one unit by another is absent.

See Karssen, *Imposing Corporate Forms on Unincorporated Denominations: Balancing Secular Accountability with Religious Free Exercise*, 55 S. Cal. L. Rev. 155, 166-70 (1981).

If a nonheirarchical association of congregations is subject to suit, it may change its polity in a way that is inconsistent with its spiritual doctrine, in order to avoid liability for the conduct of its constituent congregations (e.g., it might assume centralized control). *Id.* at 180-82. See also Everett, *Ecclesial Freedom and Federal Order: Reflections on the Pacific Homes Case*, 12 J. L. & Religion 371 (1995-96) (asserting that the UMC changed its structure and the manner in which it represented itself in the wake of the *Barr* decision).

In response to such arguments, the court stated:

> To hold UMC suable is not equivalent to a review of its polity thus interfering with its internal affairs in violation of the free exercise clause of the First Amendment. There is no evidence to show that rendering UMC amenable to suit would affect the distribution of power or property within the denomination, would modify or interfere with the modes of worship affected by Methodists or would have any effect other than to oblige UMC to defend itself when sued upon civil obligations it is alleged to have incurred. The cases involving UMC entities previously cited eliminates any idea there may be religious prohibitions to participation in civil litigation.

Barr at 274.

Consideration of fairness allows the court to concentrate on how a religious denomination *acts*, without becoming entangled in a dissection of the relationship between a denomination's spiritual doctrine and its polity. Thus, the *Barr* court emphasizes that the UMC represented itself as an entity, entered into secular business activity, and availed itself of the courts on occasion. Therefore,

under "neutral principles of law," the court could find the UMC amenable to suit.

Recommendation Regarding Section 369.5

It seems reasonable to consider fairness when determining whether an unincorporated group is subject to suit. Such analysis provides a basis for holding that an unincorporated religious denomination operates as a legal entity, regardless of its doctrinal position. Or conversely, for holding that a denomination is not an entity, where both its actions and doctrine show that it is nothing more than a nonheirarchical affiliation of congregations. In addition, there may be secular groups that are so lacking in organizational cohesion that it would be unfair to threat them as entities that can be sued (although, as a practical matter, a group with enough assets to make it worth suing is probably sufficiently well-organized to be treated as an entity).

In order to avoid superseding the criteria stated in *Barr*, the staff recommends against amending Code of Civil Procedure Section 369.5 to incorporate the proposed statutory definition of "unincorporated association." An alternative would be to codify *Barr* in Section 369.5. The staff is inclined against doing so. *Barr* has remained uncodified for 23 years without any indication that there are problems in applying Section 388 (now Section 369.5). Codifying the fairness prong at this time might simply stir up unproductive litigation, with unincorporated groups routinely asserting unfairness as a bar to suit. It is probably best to leave well enough alone.

Recommendation Regarding Proposed Section 18025

Although consideration of fairness may be useful when determining amenability to suit, the staff is inclined against adding a fairness element to proposed Section 18025, for two reasons:

(1) The resulting uncertainty could be problematic. As drafted, proposed Section 18025 provides a bright line definition — with certain stated exceptions, if an unincorporated group has a common purpose and operates under a common name, it is an unincorporated association. If fairness were an element of the definition, a group's status would never be known definitively unless it had been litigated. This uncertainty could undermine the member liability limitations in the proposed law and cast doubt on an unincorporated group's capacity to own property in its own name.

(2) Consideration of fairness is unnecessary in the context of Section 18025. Section 18025 only applies to the Corporations Code provisions of the proposed law. See proposed Section 18005. Those provisions are beneficial to an unincorporated association and its members. The staff does not see how application of those provisions could be unfair to an unincorporated group.

Of course, if an unincorporated group is insolvent, creditors of the group may argue that it is unfair to treat the group as an entity separate from its members. However, the proposed law already addresses that problem. Proposed Section 18230 expressly provides for the possibility of alter ego liability. If an unincorporated group is not actually distinct from its members, and treating it as a separate entity would result in fraud or injustice, creditors should be able to "pierce the veil" and hold individual group members liable for the debt.

In order to make it clear that proposed Section 18025 should not be used to construe the meaning of "unincorporated association" in Section 369.5, the staff recommends that the Comment to proposed Section 18025 be revised to read as follows:

> **Comment.** Section 18025 is similar to Section 1(2) of the Uniform Unincorporated Nonprofit Association Act.
>
> Subdivision (c) continues former Section 24000(b) without substantive change.
>
> This section governs the construction of this title. See Section 18005. Other standards may govern the meaning of "unincorporated association" in other provisions. For example, the meaning of "unincorporated association" in former Code of Civil Procedure Section 388(a) (continued without change in Code of Civil Procedure Section 369.5(a)) is construed in *Barr v. United Methodist Church*, 90 Cal. App. 3d 259 (1979).
>
> See also Sections 18050 (group subject to title for reasons of fairness), 18055 (exempt entities), 18060 (relation to other law).

Respectfully submitted,

Brian Hebert
Staff Counsel