Study B-501 January 22, 2001

Memorandum 2001-20

Uniform Unincorporated Nonprofit Association Act: Liability Issues

At its December 2000 meeting, the Commission made a number of decisions regarding the liability of members and officers of unincorporated nonprofit associations and instructed the staff to draft proposed legislation implementing those decisions. The draft is attached and is discussed below. Except as otherwise indicated, all statutory references in this memorandum are to the Corporations Code.

OFFICERS AND AGENTS

Previous discussions have focused on the liability of "officers" of an unincorporated association. The attached draft refers to the liability of "agents" rather than officers. The staff believes this is a better approach because it is more inclusive (non-elected and non-managerial agents would be included) and because there seems to be no reason to distinguish between officers and agents under the liability rules that have been discussed to date. The one exception relates to an existing statute providing a liability shield for directors and officers of a nonprofit medical association (discussed below). That provision is clearly aimed at persons with policymaking discretion, as distinguished from other types of agent.

In preparing the draft provisions governing liability of an agent of a nonprofit association, the staff realized that those provisions are really only restatements of general agency law principles. This raises the question of whether it is worthwhile including such provisions in the proposed legislation at all. An attempt to restate the relevant provisions of agency law creates an opportunity for error and confusion, either through misstatement or exclusion of a relevant principle, or misinterpretation of the new language. A better approach might be to delete the provisions relating to liability of an agent and replace them with a general provision along the following lines:

§ _____. Liability of agent

The liability of an agent of a nonprofit association for a debt, obligation, or liability of the association is governed by the rules of law governing agency generally.

Comment. Section _____ is new. It makes clear that an agent of a nonprofit association is subject to the same liability rules applicable to any other agent. An agent who is also a member may be liable as a consequence of actions taken as a member. See §§ 21020 & 21050.

On the other hand, considering that many members and agents of nonprofit associations will be legally unsophisticated, it might be helpful to restate the general principles of agent liability in the statutes governing nonprofit associations. A lay person could then find all of the relevant rules in one location. The staff favors replacing the restatements with the general provision set out above.

LIABILITY OF ASSOCIATION

Existing Section 24001(a) provides that an unincorporated association is liable to a person *other than a member* for its own acts and omissions, as well as those of its agents, to the same extent as if it were a natural person. That subdivision is continued without substantive change in proposed Section 21000(a).

Existing Section 24001(b) provides: "Nothing in this section in any way affects the rules of law which determine the liability between an association and a member of the association." As has been previously discussed, Section 24001 was enacted at a time when it was not clear whether a member of an unincorporated association could sue the association. Subsequent cases have held that unincorporated associations are subject to suit by their members. Consistent with the current state of the law, the staff proposes replacing existing subdivision (b) with the following:

(b) An unincorporated association may be sued by a member of the association.

The Comment to proposed subdivision (b) makes clear that it is not intended to affect the standards that govern an unincorporated association's liability to its members.

NO LIABILITY BASED SOLELY ON MEMBERSHIP OR AGENCY

Proposed Section 21010 provides that a member or agent is not personally liable for a debt, obligation, or liability of the association solely by reason of membership or agency. This is consistent with existing law and should be noncontroversial.

CONTRACT LIABILITY OF MEMBERS AND AGENTS

Member Liability

Proposed Section 21020 implements the Commission's decisions regarding the liability of a member of a nonprofit association for a contractual obligation of the association. It provides that a member is not personally liable for such an obligation unless the member has either: (1) expressly assumed liability, (2) expressly authorized or ratified the contract, or (3) knowingly received a benefit under the contract (in which case liability is limited to the value of the benefit received).

The proposed section would make three significant changes from existing law:

(1) The section would not continue the common law rule that a member may be liable for a contract that the member has *impliedly* authorized or ratified. What's more, the meaning of express authorization and ratification would be defined so as not to include "signing of by-laws, election of officers, or participation in a vote in which the member votes against authorization or ratification of the contract." As the Comment notes, "authorization and ratification may not be inferred from mere participation in the governance of the association…."

(2) Under existing law, knowing acceptance of benefits under a contract can constitute ratification of that contract. See Civ. Code § 2310 ("A ratification can be made …, by accepting or retaining the benefit of the act, with notice thereof."). Thus, a member who knowingly accepts a benefit under an association contract may be liable on that contract. This rule is partially preserved in proposed Section 21020(c). However, unlike existing law, which would apparently impose liability for the entire contract amount, the proposed law limits liability to the value of the benefit received. This would make things more difficult for creditors, who would have to obtain and enforce judgments against each member, but would protect a member from full liability for a contract that the member did not authorize.

(3) Existing Section 21100 shields a member from liability for an association contract relating to real property. The proposed law does not continue this exemption. As has been discussed previously, there are questions about the constitutionality of a statute that disadvantages real property creditors as compared with all other creditors. Also, it isn't clear what policy is served by a special exemption for real property contracts. This change may prove controversial. A note following proposed Section 21020 would specifically request input on whether there is a good reason to continue the exemption.

Liability of Agent

Proposed Section 21030 implements the Commission's decisions regarding the liability of an agent of a nonprofit association for a contractual obligation of the association. It provides that an agent is not personally liable for such an obligation unless the agent either: (1) expressly assumes liability, or (2) executes the contract without disclosing that the agent is acting as an agent of the association. This is consistent with agency law, which provides that an agent is not liable for a contract executed on behalf of a disclosed principal. In addition, the staff has added language providing that an agent may be liable on a contract if the agent lacks proper authority to contract on behalf of the association. This is also consistent with existing law. See generally 2 B. Witkin, Summary of California Law *Agency* §§ 145-48, at 141-44 (9th ed. 1987).

TORT LIABILITY OF MEMBERS AND AGENTS

Liability of Member

Proposed Section 21040 implements the Commission's decisions regarding the liability of a member of a nonprofit association for a tort of the association. It provides that a member is not personally liable for such a tort unless the member has either: (1) expressly assumed liability for the conduct which caused the injury, or (2) expressly authorized the conduct that caused the injury. There are two aspects of the proposed section that merit further discussion:

Assumption of Liability

Although the staff is unsure whether it is common for a member to assume liability for torts of the association, there seems to be nothing precluding such an arrangement. The proposed law recognizes such liability. Unlike an agreement to guarantee the debt of another, an agreement to assume liability for another's

torts does not appear to be subject to the Statute of Frauds. The Commission should consider whether to require that such an agreement be written and signed in order to be valid.

Express Authorization of Conduct

The proposed law provides that a member may be liable for a tort if the member expressly authorizes the conduct that causes the tort. Thus, if a member of an unincorporated campaign committee votes in favor of broadcasting amplified campaign messages from a sound truck, the member could be held personally liable in a resulting nuisance action. The member could also be held liable if the driver of the sound truck negligently collides with another vehicle. This is consistent with existing law providing that a principal is responsible for an agent's negligence. See Civ. Code § 2338 ("Unless required by or under the authority of law to employ that particular agent, a principal is responsible to third persons for the negligence of his agent in the transaction of the business of the agency, including wrongful acts committed by such agent in and as a part of the transaction of such business, and for his willful omission to fulfill the obligations of the principal."). See also *Steuer v. Phelps*, 41 Cal. App. 3d 468, 472 (1974), discussing the liability of members of an unincorporated nonprofit association that entrusted a car to one of their members to drive on association business:

> Mere authorization to Mrs. Henry to operate the car fastens liability upon the individual members who gave that authorization. It is by no means necessary that they approved her 'negligent acts.' The entruster of an automobile to another seldom, if ever, specifically authorizes the operator to drive negligently.

As with authorization of a contract, the proposed law provides that express authorization does not include signing of by-laws, election of officers, or participation in a vote in which the member votes against the conduct that causes an injury. Thus, in the examples cited above, a member would not be liable if the member voted against use of the sound truck, or simply remained silent on the issue.

Liability of Agent

Proposed Section 21050 implements the Commission's decisions regarding the liability of an agent of a nonprofit association for a tort of the association. It provides that an agent is not personally liable for such a tort unless the agent has

either: (1) expressly assumed liability for the conduct which caused the tort or (2) caused the tort. This is consistent with the general rule that an agent is not liable for a principal's tort if the agent is personally innocent of wrongdoing. See 2 B. Witkin, Summary of California Law *Agency* § 151, at 145-46 (9th ed. 1987).

ALTER EGO LIABILITY

Proposed Section 21060 provides that a member of a nonprofit association may be liable under the common law alter ego doctrine applicable to corporate shareholders. This would protect creditors in cases where a member of a nonprofit association is unfairly using the association as a shield against personal liability.

The proposed law provides that "differences in form between a nonprofit association and a corporation" must be taken into account in applying the alter ego doctrine to a nonprofit association. The Comment to Section 21060 provides an example:

> In applying the alter ego doctrine to unincorporated associations, courts should take into account differences in form between corporations and nonprofit associations. For example, failure to observe corporate formalities may be a factor in a decision to impose alter ego liability on shareholders of a corporation. Although it may be unreasonable to expect a nonprofit association to observe the governance formalities required of a corporation, it would be reasonable to expect that a nonprofit association will follow the governance formalities it has established for itself. Failure to do so may indicate that the personality of a nonprofit association and its members are not truly separate.

The Comment also discusses the issue of what constitutes adequate capitalization in the context of a nonprofit association.

EXHAUSTION OF ASSETS

Under existing law, a partnership is a legal entity that is liable for its own acts or omissions as well as the acts or omissions of its agents. Section 24001. General partners are also jointly and severally liable for acts or omissions of the partnership or its agents. Section 16306. Despite this shared liability, a judgment creditor must generally exhaust the resources of the partnership before the creditor can levy execution against the assets of a partner. Section 16307(d). In effect, this means that the partnership has primary liability, with partners only

secondarily liable if the partnership's assets are insufficient to satisfy the judgment. Exceptions allowing a creditor to reach a partner's assets without first exhausting partnership assets apply in the following circumstances:

- The partnership is a debtor in bankruptcy.
- The partner has agreed that the creditor need not exhaust partnership assets.
- A court grants permission to the judgment creditor to levy execution against the assets of a partner based on a finding that partnership assets subject to execution are clearly insufficient to satisfy the judgment, that exhaustion of partnership assets is excessively burdensome, or that the grant of permission is an appropriate exercise of the court's equitable powers.
- Liability is imposed on the partner by law or contract independent of the existence of the partnership.

An unincorporated association is liable for its own acts or omissions as well as the acts or omissions of its agents. In some circumstances, members or agents are also liable. Proposed Section 21070 would establish a rule analogous to the rule governing partnerships — requiring that the assets of a nonprofit association be exhausted before a judgment creditor can levy execution against the assets of a member or agent (with the exceptions listed above). In other words, the nonprofit association would have primary liability and member liability would be secondary. Considering that such a provision is more about enforcement of judgments than about liability, it may ultimately make sense to locate the provision with other civil procedure provisions.

FRAUDULENT TRANSFERS

Proposed Section 21080 provides that nothing in the proposed law affects application of the Uniform Fraudulent Transfer Act. Civ. Code §§ 3439-3439.12. The Uniform Act provides remedies for a creditor where a debtor has transferred property to a third party while insolvent. If the creditor's claim arises before the transfer occurs, then intent to defraud need not be shown to recover the property — if the debtor is insolvent and does not receive reasonable value for the transferred property, the transfer is "fraudulent" and can be avoided or the property can be attached. Civ. Code §§ 3439.05, 3439.07. This is a reasonable approach to resolving the problem of improper distribution of assets by an insolvent unincorporated association.

Existing law provides special liability protections for members and officers of nonprofit medical associations. Sections 21200 & 24001.5. The provisions of Section 21200 are continued in proposed Sections 20500 (definition of "nonprofit medical association") and 21090 (contract liability of member of nonprofit medical association). Section 24001.5 is continued without substantive change in proposed Section 21100. Three issues relating to nonprofit medical associations are discussed below.

Real Property Exemption

Existing Section 21200 provides in part:

> The members of [a nonprofit medical association] are not individually or personally liable for debts or liabilities contracted or incurred by the association in the acquisition of lands or leases or the purchase, leasing, construction, repairing or furnishing of buildings or other structures to be used for the purposes of the association or for debts or liabilities contracted or incurred by the association in the carrying out or performance of any of its purposes; provided, that the purposes are within the purposes stated in Section 21000 of this part.

The first part of this provision, creating an exemption for contracts relating to real property, is not continued in proposed Section 21090. A special exemption for contracts relating to real property is superfluous in light of the more general exemption from liability for any "debts or liabilities contracted or incurred by the association in the carrying out or performance of any of its purposes."

Scope of Exemption

Under existing law, the exemption from liability enjoyed by members appears to be absolute. This has been preserved in the attached draft. However, the Commission should consider narrowing the exemption so that a member of a nonprofit medical association is liable where the member has expressly assumed liability, or where the member has knowingly received a benefit under a contract. To preclude liability where a member has assumed liability is bad policy, as creditors could be affirmatively misled. It also seems unfair to permit a member of a nonprofit medical association to keep the benefit of a contract that has been breached by the association. If the exemption were narrowed in this way,

members would still enjoy a special exemption from liability for contracts or conduct that the members have expressly authorized or ratified.

Conduct Standard

Existing Section 24001.5 provides immunity from liability for a volunteer director or officer of a nonprofit medical association, for

> any negligent act or omission occurring (1) within the scope of that person's duties as a director acting as a board member, or within the scope of that person's duties as an officer acting in an official capacity; (2) in good faith; (3) in a manner that the person believes to be in the best interest of the association; and (4) is in the exercise of his or her policymaking judgment.

This liability shield is subject to a number of limitations. See proposed Section 21100(c) (shield does not apply to self-dealing, conflicts of interest, intentional acts, recklessness, etc.). In order for the shield to apply, the association must be tax exempt and must carry general liability insurance of a specified amount (at least $500,000). See proposed Section 21100(d)-(e). The protection from liability provided to volunteer directors and officers of an unincorporated nonprofit medical association is similar to statutory limits on the liability of a director or volunteer executive officer in a nonprofit corporation. See, e.g., §§ 7231(c) (director liability in mutual benefit corporation), 7231.5 (volunteer executive officer liability in mutual benefit corporation).

Considering how restricted the liability shield is, it may be appropriate to generalize it to apply to any nonprofit association that meets the criteria. In enacting Section 24001.5, the Legislature stated:

> The Legislature finds and declares that the services of directors or officers of nonprofit medical associations, as defined in Section 21200, who serve without compensation are critical to the efficient conduct and management of the public service and charitable affairs of the people of California. The willingness of volunteers to offer their services has been deterred by a perception that their personal assets are at risk for these activities. The unavailability and unaffordability of appropriate liability insurance makes it difficult for these associations to protect the personal assets of their volunteer decisionmakers with adequate insurance. It is the public policy of this state to provide incentive and protection to the individuals who perform these important functions.

This justification would also seem to support shielding volunteer directors and officers of other nonprofit associations from liability. The Commission should consider generalizing the liability shield provision so that it applies to all nonprofit associations, not just nonprofit medical associations.

WHAT NEXT?

Assuming satisfactory resolution of the liability issues discussed in this memorandum, the staff will next consider definitions (of "unincorporated association," "nonprofit association," and "member") and matters of civil procedure. Discussion of property issues and possible governance rules will follow after.

Respectfully submitted,

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Staff Counsel

PROPOSED LEGISLATION

Note: This is a discussion draft of provisions relating to the liability of unincorporated nonprofit associations. The organizational scheme reflected below is provisional. The optimal organization of statutes relating to unincorporated associations will be considered by the Commission at a later date.

Corp. Code §§ 20000-24007 (repealed). Unincorporated associations

SECTION. 1. Title 3 (commencing with Section 20000) of the Corporations Code is repealed.

Corp. Code §§ 20000-_____ (added). Unincorporated associations

SEC. 2. Title 3 (commencing with Section 20000) is added to the Corporations Code, to read:

TITLE 3. UNINCORPORATED ASSOCIATIONS

CHAPTER 1. GENERAL PROVISIONS

Corp. Code §20500. "Nonprofit medical association" defined

20500. "Nonprofit medical association" means an unincorporated association that is an organized medical society limiting its membership to licensed physicians and surgeons and that has as members at least 25 percent of the eligible physicians and surgeons residing in the area in which it functions (which must be at least one

county). However, if the association has less than 100 members, it shall have as members at least a majority of the eligible persons or licensees in the geographic area served by the particular association.

Comment. Section 20500 continues the definition provisions of former Section 21200 without substantive change. Provisions of former Section 21200 relating to property powers are continued in Section ____. Provisions of former Section 21200 relating to the liability of a member of a nonprofit medical association are continued in Section 21090.

☞ **Staff Note.** The provision governing property powers of a nonprofit medical association will be considered in a later memorandum.

CHAPTER 2. PROPERTY [RESERVED]

CHAPTER 3. LIABILITY

Article 1. General Provisions

Corp. Code § 21000. Liability of unincorporated association

21000. (a) Except as otherwise provided by statute, an unincorporated association is liable as if it were a natural person, to a person who is not a member of the association, for an act or omission of the association or of its officer, agent, or employee acting within the scope of the office, agency, or employment.

(b) An unincorporated association may be sued by a member of the association.

Comment. Section 21000(a) continues former Section 24001(a) without substantive change. It has been redrafted to improve its clarity and to correct a gender-specific reference.

Subdivision (b) is new. It makes clear that an unincorporated association may be sued by a member. This is consistent with the common law. See Marshall v. ILWU, 57 Cal. 2d 781 (1962) (member can sue labor union for negligent acts which member neither participated in nor authorized), White v. Cox, 17 Cal. App. 3d 824 (1971) ("unincorporated associations are now entitled to general recognition as separate legal entities and … as a consequence a member of an unincorporated association may maintain a tort action against his association."). This subdivision has no affect on the substantive law governing the liability of an unincorporated association to a member. For example, in Lamden v. La Jolla Shores Clubdominium Homeowners Ass'n, 21 Cal. 4th 249 (1999), the court held that courts should defer to a decision of a duly-constituted community association board, where the board, "upon reasonable investigation, in good faith, and with regard for the best interests of the community association and its members, exercises discretion within the scope of its authority under relevant statutes, covenants and restrictions to select among means for discharging an obligation to maintain and repair a development's common areas…." Subdivision (b) does not affect the rule announced in that case.

☞ **Staff Note.** The phrasing of existing subdivision (a) is somewhat awkward. The staff will propose a clearer version of the provision in a later draft.

Corp. Code § 21010. No liability based solely on membership or agency

21010. A member or agent of a nonprofit association is not personally liable for a debt, obligation, or liability of the association solely by reason of being a member or agent.

Comment. Section 21010 codifies the general rule that a member of an unincorporated nonprofit association is not personally liable for the association's debts, obligations, or liabilities

solely by reason of membership. See Security First National Bank of Los Angeles v. Cooper, 62 Cal. App. 2d 653, 667 (1945) ("membership, as such, imposes no personal liability for the debts of the association"); Orser v. George, 252 Cal. App. 2d 660, 670 (1967) ("mere membership does not make all members liable for unlawful acts of other members without their participation, knowledge or approval").

The general rule has been extended to agents of an association. This is consistent with existing law providing that an agent is not liable for obligations of a disclosed principal or for torts of the principal, where the agent is personally innocent of wrongdoing. See 2 B. Witkin, Summary of California Law *Agency* § 145, at 141, § 151, at 145 (9th ed. 1987).

Corp. Code § 21020. Contract liability of member of nonprofit association

21020. A member of a nonprofit association may not be held personally liable for a contractual obligation of the association, except in one of the following circumstances:

(a) The member expressly assumes personal responsibility for the obligation.

(b) The member expressly authorizes or ratifies the contract. For the purposes of this paragraph, express authorization or ratification of a contract does not include signing of by-laws, election of officers, or participation in a vote in which the member votes against authorization or ratification of the contract.

(c) With notice of the contract, the member receives a benefit under the contract. Liability under this subdivision is limited to the value of the benefit received.

Comment. Section 21020 is new. It specifies the scope of personal liability of a member of a nonprofit association for a contractual obligation of the association.

Subdivision (a) provides that a member may be liable where the member has personally guaranteed a debt or otherwise assumed responsibility for a contract. A promise to answer for the debt of another is subject to the statute of frauds. Civ. Code § 1624(a)(2).

Subdivision (b) codifies the common law rule that a member of a nonprofit association may be personally liable for a contractual obligation that the member has expressly authorized or ratified. See Security First National Bank of Los Angeles v. Cooper, 62 Cal. App. 2d 653 (1944). Subdivision (b) does not continue the common law rule that a member may be liable for a contract that the member has impliedly authorized or ratified. Authorization and ratification may not be inferred from mere participation in the governance of the association — express approval of the contract is required.

Nothing in this section affects the liability of a member who is acting as an agent of the association, under the law governing liability of agents. See Sections 21030, 21050.

☞ **Staff Note.** Proposed Section 21020 would not continue existing Section 21100, which provides that a member of an unincorporated nonprofit association is not "individually or personally liable for debts or liabilities contracted or incurred by the association in the acquisition of lands or leases or the purchase, leasing, designing, planning, architectural supervision, erection, construction, repair, or furnishing of buildings or other structures, to be used for the purposes of the association."

It is not clear what purpose is served by this exemption — why should these types of debts and liabilities be treated differently from others? In fact, the Legislative Counsel has questioned whether the distinction drawn in Section 21100 is unconstitutional as special legislation (Wood, Report on Assembly Bill No. 356 4-5 (April 21, 1945) (on file with the Commission)):

> Those creditors who had contracts of the kinds described in the bill would have a more restricted recourse to members' property than would those creditors who sold food, an aircraft, a ship or furnishings for it, or musical instruments for a band, or who performed the services of secretaries, janitors or clergymen.

…

I have not been able to conceive of a state of facts that would show that the classification of debts and liabilities contained in the bill is founded on a natural, intrinsic or constitutional distinction which reasonably justifies different treatment from that which would be given to debts and liabilities not mentioned in it; although I freely admit that it is hypothetically possible that a court might find such a distinction. It is my opinion that grave doubt exists as to whether a court would find the proposed legislation to be constitutional as far as the classification affects it.

The Commission would like to receive input on whether Section 21100 should be continued, and if so, why.

Corp. Code § 21030. Contract liability of agent of nonprofit association

21030. An agent of a nonprofit association may not be held personally liable for a contractual obligation of the nonprofit association, except in one of the following circumstances:

(a) The agent expressly assumes personal responsibility for the obligation.

(b) The agent executes the contract without disclosing that the agent is acting as the agent of the association.

(c) The agent executes the contract without authority to execute the contract.

Comment. Section 21030 is new. It specifies the scope of personal liability of an agent of a nonprofit association for a contractual obligation of the association.

Subdivision (a) provides that an agent may be liable where the agent has personally guaranteed a debt or otherwise assumed responsibility for a contract. A promise to answer for the debt of another is subject to the statute of frauds. Civ. Code § 1624(a)(2).

Subdivision (b) is consistent with existing law providing that an agent is not liable for contracts entered into on behalf of a disclosed principal. See 2 B. Witkin, Summary of California Law *Agency* § 145-48, at 141-44 (9th ed. 1987).

Subdivision (c) provides that an agent may be liable for a contract executed on behalf of an association if the agent lacks authority to execute the contract. See Civ. Code §§ 2342 (warranty of authority), 2343(2) (bad faith representation of authority), 2 B. Witkin, Summary of California Law *Agency* §§ 144-45, at 141-42 (9th ed. 1987).

Nothing in this section affects the liability of an agent who is also a member of the association, under the law governing liability of members. See Sections 21020, 21040.

Corp. Code § 21040. Tort liability of member of nonprofit association

21040. A member of a nonprofit association may not be held personally liable for an injury caused by an act or omission of the association or an agent of the association, except in one of the following circumstances:

(a) The member expressly assumes liability for any injury caused by particular conduct and that conduct causes an injury.

(b) The member expressly authorizes conduct that causes an injury. Express authorization of conduct does not include signing of by-laws, election of officers, or participation in a vote in which the member votes against authorization of the conduct.

Comment. Section 21040 is new. It specifies the scope of personal liability of a member of a nonprofit association for a tort of the association or of an agent of the association.

Subdivision (a) provides that a member may be liable where the member has personally assumed responsibility for conduct that causes an injury.

Subdivision (b) provides that a member of a nonprofit association is liable for the conduct of the association and its agents where the member has expressly authorized that conduct. This is consistent with the common law. See Steuer v. Phelps, 41 Cal. App. 3d 468 (1974) (liability may be based on authorization of activity that causes injury, under doctrine of respondeat superior). Liability under this section does not depend on authorization of specific wrongful acts or omissions. If a member authorizes an agent's conduct and that agent's negligence causes an injury, the member may be liable despite the fact that the member did not authorize the agent to act negligently. See Civ. Code §§ 2338-2339. Authorization of conduct that causes an injury may not be inferred from mere participation in the governance of the association — express approval of the conduct is required.

Section 21040 states the circumstances in which a member may be liable, but these circumstances alone are not sufficient to establish liability. For example, subdivision (c) provides that a member may be liable if the member's conduct causes an injury. However, a member would not be liable to a person injured by the member's conduct unless the member also owed a duty of care to the injured person and had breached that duty.

Nothing in this section affects the liability of a member who is acting as an agent of the association, under the law governing liability of agents. See Sections 21030, 21050.

☞ **Staff Note.** As discussed in the Staff Note following proposed Section 21020, the proposed law does not continue Section 21100, which provides that a member of a nonprofit association is not personally liable for debts or liabilities contracted or incurred in connection with specified real property matters. Although Section 21100 was enacted in response to a case involving contractual liability, as drafted it also limits liability for torts relating to the specified real property transactions. The Commission would like to receive input on whether there is good justification for such an exemption.

Corp. Code § 21050. Tort liability of agent of nonprofit association

21050. An agent of a nonprofit association may not be held personally liable for an injury caused by an act or omission of the association or an agent of the association, except in one of the following circumstances:

(a) The agent expressly assumes liability for any injury caused by particular conduct and that conduct causes an injury.

(b) The agent's own conduct causes an injury.

Comment. Section 21050 is new. It specifies the scope of personal liability of an agent of a nonprofit association for a tort of the association or an agent of the association.

Section 21050 states the circumstances in which an agent may be liable, but these circumstances alone are not sufficient to establish liability. For example, subdivision (c) provides that an agent may be liable if the agent's conduct causes an injury. However, an agent would not be liable to a person injured by the agent's conduct unless the agent also owed a duty of care to the injured person and had breached that duty.

Nothing in this section affects the liability of an agent who is also a member of the association, under the law governing liability of members. See Sections 21020, 21040.

Corp. Code § 21060. Alter ego liability of member of nonprofit association

21060. Notwithstanding any other provision of this chapter, a member of a nonprofit association may be personally liable for a debt, obligation, or liability of the association under the common law governing alter ego liability of shareholders of a corporation, taking into account differences in form between a nonprofit association and a corporation.

Comment. Section 21060 is new. It provides that the common law alter ego doctrine applicable to corporations may also be applied to nonprofit associations. The alter ego doctrine is summarized in *Communist Party of the United States v. 522 Valencia, Inc.*, 35 Cal. App. 4th 980, 993 (1995) ("In general, the two requirements for applying the alter ego doctrine are that (1) there is such a unity of interest and ownership between the corporation and the individual or organization controlling it that their separate personalities no longer exist, and (2) failure to disregard the corporate entity would sanction a fraud or promote injustice.").

In applying the alter ego doctrine to unincorporated associations, courts should take into account differences in form between corporations and nonprofit associations. For example, failure to observe corporate formalities may be a factor in a decision to impose alter ego liability on shareholders of a corporation. Although it may be unreasonable to expect a nonprofit association to observe the governance formalities required of a corporation, it would be reasonable to expect that a nonprofit association will follow the governance formalities it has established for itself. Failure to do so may indicate that the personality of a nonprofit association and its members are not truly separate.

Failure to provide a corporation with reasonably adequate assets to cover its prospective liabilities may also justify imposing alter ego liability on shareholders of a corporation. In Automotriz del Golfo de California v. Resnick, 47 Cal. 2d 792, 797 (1957), the court relied in part on inadequate capitalization to justify imposing alter ego liability (quoting Ballantine on Corporations (1946)):

> If a corporation is organized and carries on business without substantial capital in such a way that the corporation is likely to have no sufficient assets available to meet its debts, it is inequitable that shareholders should set up such a flimsy organization to escape personal liability. The attempt to do corporate business without providing any sufficient basis of financial responsibility to creditors is an abuse of the separate entity and will be ineffectual to exempt the shareholders from corporate debts. It is coming to be recognized as the policy of the law that shareholders should in good faith put at the risk of the business unencumbered capital reasonably adequate for its prospective liabilities. If the capital is illusory or trifling compared with the business to be done and the risks of loss, this is a ground for denying the separate entity privilege.

This principle could also be applied to nonprofit associations. However, it would be necessary to carefully consider the nature of the association to determine what level of unencumbered capital would be reasonably adequate for the association's prospective liabilities. For example, a small historical society, operating a museum that is open to the public, should probably insure against liability for any injuries suffered by the public while in the museum. Such insurance might reasonably be considered adequate capitalization. On the other hand, an association that publishes controversial and potentially defamatory commentaries about public figures might reasonably anticipate considerable liability. If the association fails to insure against that risk or maintain a cash reserve to satisfy any judgment against it, a court might conclude that the association is inadequately capitalized.

Corp. Code § 21070. Exhaustion of association assets required before reaching assets of liable members and agents

21070. (a) A judgment creditor of a member or agent of a nonprofit association may not levy execution against the assets of the member or agent to satisfy a judgment based on a claim against the nonprofit association unless any of the following apply:

(1) A judgment based on the same claim has been obtained against the nonprofit association and a writ of execution on the judgment has been returned unsatisfied in whole or in part.

(2) The nonprofit association is a debtor in bankruptcy.

(3) The member or agent has agreed that the creditor need not exhaust the assets of the nonprofit association.

(4) A court grants permission to the judgment creditor to levy execution against the assets of a member or agent based on a finding that assets of the nonprofit association subject to execution are clearly insufficient to satisfy the judgment, that exhaustion of the assets of the nonprofit association is excessively burdensome, or that the grant of permission is an appropriate exercise of the court's equitable powers.

(b) Nothing in this section affects the right of a judgment creditor to levy execution against the assets of a member of a nonprofit association where the claim against the member is independent of any claim against the nonprofit association.

Comment. Section 21070 is similar to Section 16307(d) (exhaustion of partnership assets). It provides that a judgment creditor of a nonprofit association must exhaust the assets of the association before reaching the assets of any member or agent who is also liable, except in the specified circumstances.

Subdivision (b) makes clear that the section does not affect enforcement of a judgment against a member of a nonprofit association where the member's liability is independent of the liability of the association. For example, if the member personally guarantees a contract, or the member's own conduct causes a tort, a judgment creditor would not need to exhaust the association's assets before levying execution against the assets of the member.

Corp. Code § 21080. Fraudulent transfers

21080. Nothing in this chapter affects application of the Uniform Fraudulent Transfer Act.

Comment. Section 21080 is new. It makes clear that limits on liability provided in this chapter do not affect the application of the Uniform Fraudulent Transfer Act. See Civ. Code §§ 3439-3439.12. Thus, if an insolvent association transfers assets to a member (e.g., through a general distribution or redemption of membership), those assets may be subject to attachment by a creditor, regardless of whether the member is personally liable for the debt.

ARTICLE 2. NONPROFIT MEDICAL ASSOCIATIONS

Corp. Code § 21090. Liability of member of nonprofit medical association

21090. Notwithstanding Sections 21020 and 21040, a member of a nonprofit medical association is not individually or personally liable for debts or liabilities contracted or incurred by the association in the carrying out or performance of any of its nonprofit purposes.

Comment. Section 21090 continues the member liability provisions of former Section 21200 without substantive change. Language in former Section 21200 limiting liability for "debts or liabilities contracted or incurred by the association in the acquisition of lands or leases or the purchase, leasing, construction, repairing or furnishing of buildings or other structures to be used for the purposes of the association" is superfluous and has not been continued. The introductory clause makes clear that a member of a nonprofit medical association is not subject to liability on the grounds provided in Sections 21020 and 21040.

Corp. Code § 21100. Liability of director or officer of nonprofit medical association

21100. (a) The Legislature finds and declares that the services of directors or officers of nonprofit medical associations who serve without compensation are critical to the efficient conduct and management of the public service and charitable affairs of the people of California. The willingness of volunteers to offer their services has been deterred by a perception that their personal assets are at risk for these activities. The unavailability and unaffordability of appropriate liability insurance makes it difficult for these associations to protect the personal assets of their volunteer decisionmakers with adequate insurance. It is the public policy of this state to provide incentive and protection to the individuals who perform these important functions.

(b) Except as provided in this section, no cause of action for monetary damages shall arise against any person serving without compensation as a director or officer of a nonprofit medical association, on account of any negligent act or omission occurring (1) within the scope of that person's duties as a director acting as a board member, or within the scope of that person's duties as an officer acting in an official capacity; (2) in good faith; (3) in a manner that the person believes to be in the best interest of the association; and (4) is in the exercise of his or her policymaking judgment.

(c) This section shall not limit the liability of a director or officer for any of the following:

(1) Self-dealing transactions, as described in Sections 5233 and 9243.

(2) Conflicts of interest, as described in Section 7233.

(3) Actions described in Sections 5237, 7236, and 9245.

(4) In the case of a charitable trust, an action or proceeding against a trustee brought by a beneficiary of that trust.

(5) Any action or proceeding brought by the Attorney General.

(6) Intentional, wanton, or reckless acts, gross negligence, or an action based on fraud, oppression, or malice.

(7) Any action brought under Chapter 2 (commencing with Section 16700) of Part 2 of Division 7 of the Business and Professions Code.

(d) This section only applies to nonprofit organizations organized to provide charitable, educational, scientific, social, or other forms of public service that are exempt from federal income taxation under Section 501(c)(3) or 501(c)(6) of the Internal Revenue Code.

(e) This section applies only if the nonprofit association maintains a general liability insurance policy with an amount of coverage of at least the following amounts:

(1) If the association's annual budget is less than fifty thousand dollars ($50,000), the minimum required amount is five hundred thousand dollars ($500,000).

(2) If the association's annual budget equals or exceeds fifty thousand dollars ($50,000), the minimum required amount is one million dollars ($1,000,000).

This section applies only if the general liability insurance policy is in force both at the time of injury and at the time that the claim is made, so that the policy is applicable to the claim.

(f) For the purposes of this section, the payment of actual expenses incurred in attending meetings or otherwise in the execution of the duties of a director or officer shall not constitute compensation.

(g) Nothing in this section shall be construed to limit the liability of a nonprofit association for any negligent act or omission of a director, officer employee, agent, or servant occurring within the scope of his or her duties.

(h) This section does not apply to any association that unlawfully restricts membership, services, or benefits conferred on the basis of race, religious creed, color, national origin, ancestry, sex, marital status, disability, political affiliation, or age.

(i) This section does not apply to any volunteer director or officer who receives compensation from the association in any other capacity, including, but not limited to, as an employee.

Comment. Section 21100 continues former Section 24001.5 without substantive change. References to the definition of "nonprofit medical association" in former section 21200 are superfluous and have not been continued. See Section 20500 ("nonprofit medical association" defined).

CHAPTER 4. GOVERNANCE [RESERVED]

CHAPTER 5. JOINT STOCK ASSOCIATIONS [RESERVED]

CHAPTER 6. REAL ESTATE INVESTMENT TRUSTS [RESERVED]