Study B-501 March 19, 2001

First Supplement to Memorandum 2001-20

Uniform Unincorporated Nonprofit Association Act: Liability Issues

Memorandum 2001-20 presents a discussion draft of proposed legislation governing the contract and tort liability of a member or agent of a nonprofit association. R. Bradbury Clark, of the State Bar Nonprofit Organizations Committee, has briefly reviewed the discussion draft and made a number of comments to the staff. Issues raised by his comments are discussed below.

LIABILITY BASED ON EXPRESS AUTHORIZATION OR RATIFICATION

Contracts

Under the proposed law, a member of a nonprofit association may be personally liable for an association contract if the member "expressly authorizes or ratifies the contract." See proposed Section 21020(b). The proposed law further provides that 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." *Id.* The concept is that mere participation in the general governance of an association should not result in personal liability for a particular association contract — authorization or ratification of the specific contract is required for liability to attach.

Mr. Clark is concerned that the statutory list of activities that do not constitute express authorization or ratification is too narrow. For example, approval of an association's budget or a general program of activities could perhaps be considered authorization or ratification of contracts that arise out of the budget or program. This concern is partly answered by the Comment to proposed Section 21020, which includes the following sentence:

> Authorization and ratification may not be inferred from mere participation in the governance of the association — express approval of the contract is required.

If the Commission feels that further clarification would be helpful, the statutory list of excluded activities could be revised to read as follows:

> For the purposes of this paragraph, express authorization or ratification of a contract does not include signing of by-laws, election of officers, approval of a budget or program of activities that does not specifically refer to the contract, or participation in a vote in which the member votes against authorization or ratification of the contract.

The requirement that the budget or program specifically refer to the contract is fairly strict, but this seems appropriate. A person should not be bound by a contract that the person may not know exists and has never had an opportunity to review.

Torts

The proposed law provides that a member of a nonprofit association may be personally liable for an injury caused by an act or omission of the association or an agent of the association if the member "expressly authorizes conduct that causes an injury." See proposed Section 21040(b). It further 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 authorization of the conduct." With respect to this rule, Mr. Clark raises a concern similar to that discussed above — should approval of a budget or general program of activities constitute express authorization of any conduct arising from the budget or program?

The key issue seems to be: when should authorization of a general program of activities be considered authorization of specific conduct undertaken in the course of that program? For example, if the members of a campaign committee authorize a program of "advertising," should that be considered authorization of a specific defamatory ad which was never reviewed by the members? Would it matter if the members knew that ads critical of opposing candidates would be published? One approach to answering this question would be to treat authorization of a general program as authorization of all activity that is foreseeably related to implementation of that program. This approach would take into account the specific facts of each situation, only holding members responsible for conduct which they should have known they might be authorizing when approving a general program.

This approach could be implemented by adding the following language to Section 21040(b) and its Comment:

> Express authorization of a general program of activity is not authorization of specific conduct unless it is reasonably foreseeable that the program would involve the specific conduct.
>
> **Comment**. … Authorization of a general program of activities constitutes authorization of specific conduct if it is reasonably foreseeable that the program will involve the conduct. E.g., it may be reasonably foreseeable that an advertising campaign promoting a candidate for public office will involve publication of advertisements criticizing the candidate's opponents.

MEANING OF "INJURY"

The provisions of the proposed law relating to tort liability refer to "an injury caused by an act or omission of the association or an agent of the association." Mr. Clark wonders whether the term "injury" includes a nonphysical injury, such as damage to one's reputation. In drafting these provisions, the staff intended that they apply to both physical and non-physical injuries. If the Commission agrees that they should, and believes that this should be clearer, each of the relevant provisions could be revised as follows:

> a physical or nonphysical injury caused by an act or omission of the association or an agent of the association.

Alternatively, language could be added to each of the relevant Comments to read:

> As used in this section, "injury" means both physical and nonphysical injuries, including death, injury to a person, damage to or loss of property, or any other injury that a person may suffer to person, reputation, character, feelings, or estate.

The catalog of injuries in the proposed Comment language is drawn from Government Code Section 810.8, defining "injury" for the purposes of the Tort Claims Act (a Commission-drafted provision).

A third alternative would be to define the term "injury" in a separate section, with language similar to that set out above. **The staff feels that any of these alternatives would be acceptable.** Adding a separate definition of "injury" is slightly more efficient from a drafting point of view.

AGENT LIABILITY

Reiteration of Agency Law

In the main memorandum, the staff points out that the provisions of the proposed law governing liability of an agent of a nonprofit association for contracts or torts of the association really just reiterate applicable provisions of agency law. The staff then asks whether this is a good approach, or if it would be better to add a general statement to the effect that liability of an agent of a nonprofit association is governed by agency law. Mr. Clark comments that it is probably best to be comprehensive and include provisions reiterating agency law in the law of unincorporated associations. This would make it easier for laypersons to understand the potential liability that attaches to their actions as agents of a nonprofit association.

Definition of "Agent"

In the main memorandum, the staff indicates that "agent" is intended to include "officers." Mr. Clark thinks it would be helpful if this were stated expressly in the law, perhaps in a definition provision indicating that "agent" includes directors, officers, and employees. **The staff agrees** that clarification would be helpful and recommends that this issue be addressed in the discussion of definitions that will follow in a later memorandum.

DIRECTOR LIABILITY

Existing Section 24001.5 (proposed Section 21100) protects a volunteer director or officer of a nonprofit medical association from liability for good faith errors in policy judgment. In the main memorandum, the staff suggests that this provision should perhaps be generalized to apply to a volunteer director or officer of any nonprofit association. Mr. Clark agrees that a significant broadening of the provision may be beneficial. However, he points out some technical problems with the provision:

Limits on Scope of Protection

Subdivision (c) provides as follows:

> (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.

Mr. Clark questions whether references to Sections 5233, 5237, 7233, 7236, 9243, and 9245 are proper, considering that those provisions are drafted to apply to nonprofit *corporations*. Problems in applying these sections in the context of nonprofit associations are discussed below:

Self-Dealing and Conflicts of Interest

Sections 5233, 7233, 9243 refer to corporations, and assume a corporate system of governance, which may raise technical problems if the sections are incorporated by reference. However, there is no conceptual obstacle to providing that the protection of a director or officer who makes a good faith error in policy judgment does not extend to transactions involving self-dealing or a conflict of interest. The terminology problem could perhaps be avoided by revising subdivision (c)(1)-(2) to read:

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

(1) Self-dealing transactions <u>that are the equivalent of a self-dealing transaction of a nonprofit public benefit or religious corporation</u>, as described in Sections 5233 and 9243.

(2) Conflicts of interest <u>that are the equivalent of a conflict of interest in a transaction of a nonprofit mutual benefit corporation</u>, as described in Section 7233.

This language incorporates by analogy, so corporation-specific language in the referenced sections shouldn't be a problem.

Another problem, similar to that discussed immediately below, is that there doesn't seem to be any statutory prohibition against self-dealing or creating a conflict of interest that applies to unincorporated associations. Under the law governing nonprofit corporations, specific statutory remedies are created to redress self-dealing and self-interested decisionmaking. See, e.g., Section 5233(h). In the absence of any prohibition applicable to an unincorporated association,

there may not be any director liability for such transactions, in which case the exception may serve no purpose. The Commission may wish to include a note in the proposed legislation, asking for input on whether subdivision (c)(1) & (2) serve a useful purpose.

Prohibited Actions

Sections 5237, 7236, and 9245 prohibit a range of actions by directors of corporations that are not prohibited to directors of nonprofit associations, either under existing law or the proposed law. These include: making a distribution, distributing assets after institution of proceedings to dissolve a corporation, without providing for known liabilities, and loaning money or property to guarantee an obligation of a director. Considering that a director of a nonprofit association is not prohibited from taking these actions, it isn't clear whether Section 24001.5(c)(3) serves any purpose. For the purpose of the tentative recommendation, it may make sense to delete subdivision (c)(3) and add a note asking for feedback on the change.

Insurance Requirement

Subdivision (e) provides that the protection from liability for good faith errors in policy judgment only applies if a nonprofit medical association maintains general liability insurance of the specified minimum amounts. Also, the unenumerated paragraph after subdivision (e)(2) provides:

> 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.

Section 5047.5 is nearly identical to Section 24001.5, protecting a director of a public benefit corporation from liability for good faith errors in policy judgment. Originally, Section 5047.5 contained language identical to that set out above. It was later amended to read as follows:

> This section applies only if the claim against the director or officer may also be made directly against the corporation and a general liability insurance policy is in force both at the time of injury and at the time the claim against the corporation is made, so that a policy is applicable to the claim. If a general liability policy is found to cover the damages caused by the director or officer, no cause of action as provided in this section shall be maintained against the director or officer.

Mr. Clark suggests that this language may be preferable. It clarifies that the association must be insured *and* must itself be liable in order for the director to be protected from liability. The staff see no problem with using language drawn from Section 5047.5 in the proposed law.

TECHNICAL DRAFTING SUGGESTIONS

Technical drafting suggestions made by Mr. Clark are discussed below. The staff does not intend to discuss these items at the meeting, unless requested.

Approval of By-Laws

Proposed Sections 21020(b) and 21040(b) provide that express authorization of a contract or tortious conduct does not include "signing of by-laws." This may be too narrow. For example, members may approve of by-laws by a roll-call vote. **The staff recommends** that the phrase be revised to read "approval of by-laws."

"May Not Be Held Personally Liable" v. "Is Not Personally Liable"

The proposed law provides that a member or agent of a nonprofit association "may not be held personally liable" for contract obligations or torts of the association, except in the specified circumstances. See proposed Sections 21020-21050. Mr. Clark suggests that "may not be held" should perhaps be replaced with "is not." **The staff agrees** that this is cleaner language and has no objection to making the suggested changes.

Clarify Comment to Proposed Section 21090

Proposed Section 21090 continues the existing rule that a member of a nonprofit medical association is not personally liable for "debts or liabilities contracted or incurred by the association in the carrying out or performance of any of its nonprofit purposes." It does not continue language providing that a member is not 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." The latter exemption is superfluous, given the breadth of the former. The Comment to proposed Section 21090 notes that the latter exemption is superfluous and is not continued, but does not explain why it is superfluous. Mr. Clark suggests that an explanation be made. **The staff has no objection** to clarifying the Comment in this way.

General Drafting Improvements

The staff intends to make a number of technical improvements to the proposed law, consistent with Commission drafting style. For example, Section 24001.5(c)(1) contains a list of items. Some of these items are plural, others are singular. The staff will redraft the list to consistently use the singular. Other similar changes will be made throughout the draft.

Respectfully submitted,

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