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North Carolina Has Rewritten Its Warpy Law of Unincorporated Associations

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Unincorporated associations are groups that may be loosely or tightly organized, but that are not incorporated under applicable laws. They are merely bodies of individuals who are acting together with a common purpose and using some practices of incorporated entities in their governance.

Examples include sports teams, civic clubs, Sunday School classes and churches, homeowners associations, neighborhood and political groups, youth groups, and informal charities of all kinds. These are merely examples. They also may include unions, trade associations, cooperatives and pressure groups—and, brotherhoods, sects, fringe groups and terrorist organizations— maybe, also, cooperatives, collectives and online communities. There's no end to them: groups with common purposes that are not incorporated.

We are told that our very genes impel us to form cooperative alliances of this sort; and authors ranging from Baron de Tocqueville to Alvin Toffler and Tom Friedman maintain that they are foundational to American democracy, and that new kinds of them will be the building blocks of the global economy in the digital future.

The common law never knew exactly what to make of them—especially the nonprofit ones. Common law knew natural persons, and it knew entities. It saw no other choices. With this in mind, Justice Sam Ervin opined that unincorporated associations do not exist under North Carolina law. For legal purposes, he said, "an unincorporated association [is] an 'airy nothing,' or a 'non-existent legal ghost,' no matter how powerful it may be in reality."

The Problems with Them

Denying that they exist only encouraged them. Now, there are more than ever. They range from the aforementioned cooperatives, funds, and groups to the likes of the Atlantic Coast Conference and—until 1992—the American Bar Association. As might be expected, "non-existent ghosts" that are nonetheless "powerful in reality" create a host of troublesome legal questions.

These include:

- What is an unincorporated association: an entity, a partnership, some sort of joint or common tenancy? Is it enough to say that they don't exist, when there are so many of them?

- Can an unincorporated group own or hold property (say, a bank account or real estate) in its own name?
- Can an unincorporated group enter into a contract? Who is bound?
- Can an unincorporated group sue or be sued in the name of the group?
- Who is liable for torts committed by members of a group in the furtherance of its common purposes?
- Where a group has become inactive or dissolved, who owns any property that may have been held in the group's name (say, a dormant bank account)?
- How can a third person know (1) the proper name of an unincorporated group? or (2) who has authority to act on behalf of the group? or (3) the address or location of the group? or (4) how disputes among group members (e.g., the right to funds on deposit) will be decided?

In short, Sam Ervin's answer to these questions was to say that an unincorporated association was not an "entity"; it had no separate existence. So, for Justice Ervin, to say that anything was done by an unincorporated group was only to say that the individual members had done it, acting together. The group was not different from the members, one by one.

In North Carolina then, applicable rules were: Property of a group is owned by all members, as tenants in common. A contract with a group is actually a contract with each of the members. Liabilities belong to members individually. An association cannot be dissolved without the unanimous consent of its members. Any lawsuits must be prosecuted in the separate names of all of the members of the group. The group has no legal standing to speak for any of its members. Any name that a group may adopt is merely an assumed name, used as a proxy for the separate names of all the members.

This produced unsatisfactory outcomes of all sorts. For example,

- Should funds donated to an unincorporated charity fund belong to the last member, after other members move on?
- Should all the members of a team be vicariously liable if one of its members has an automobile accident on a team trip?

- What sense does it make to require every member of a group to be named in a deed, or listed as owners of a bank account?

- How many members of clubs and teams and neighborhood associations and political action groups would join, if they understand that they might be liable for the group's contracts and commitments?

And there are other problems. Suppose a member of a team or class stops attending activities, perhaps having moved to another state. Is that person still a member? Where a group has no formal name, no officers, and no address, how do you know when you are dealing with one person and when with the group?

Piecemeal and Inconsistent Answers

Armed only with the theory that these associations do not exist, courts and legislatures stumbled to a variety of piecemeal and often inconsistent responses to these problems. Like most other states, North Carolina adopted scattered statutes that dealt with some issues in some contexts. They included:

- *Churches*. As might have been expected, North Carolina has special rules for churches, Chapter 61 of the General Statutes. Chapter 61anticipates common issues that unincorporated religious groups might face. It is limited to ecclesiastical bodies, churches, denominations, societies, congregations and sects (none of which are defined).

- *Real estate*. Chapter 39, Article 4 ironed out the most common real estate title issues for associations of individuals organized for charitable, fraternal, religious, social or patriotic purposes when organized for the purposes which are not prohibited by law." At the end though, it did not really say exactly who owns property held in the name of such a group.

- *Lawsuits*. N.C.G.S. Section 1-69.1 authorized unincorporated associations, whether organized for profit or not, to sue and be sued under "the name by which they are commonly known" without naming the individual members. In that case, judgments would attach to an association's assets "as if it were incorporated." Chapter 1 conflicted with Chapter 66. One said that an association must record its name under the assumed name statute in order to file a lawsuit; the other said not. Ultimately, the Court of Appeals resolved the conflict. (Doesn't matter how any longer. See discussion below.)

On balance, the law of unincorporated associations is a warp or gap in the seamless web. The common law denies their existence. Legislatures patched over pressing practical problems, but did no more than that. And any group with the competence or resources to care, soon got itself into some other form: trust, partnership, for-profit or nonprofit entity. This left the informal, the unsophisticated, the unresourced and the underground groups in the gap. The law remained—messy.

The Uniform Unincorporated Nonprofit Associations Act

Into the breach stepped the National Conference of Commissioners on Uniform State Laws. In the early 1990s NCCUSL resolved to bring order where the common law had failed. NCCUSL failed too. That is, it drafted a model statute, the Uniform Unincorporated Nonprofit Associations Act. And, the draft does bring clarity in three areas: (1) authority to acquire, hold, and transfer property, especially real property; (2) authority to sue and be sued as an entity; and (3) contract and tort liability of officers and members of associations. But, the drafters bowed to defeat in other areas, including governance, corporate names and defining what is arguably the central concept of the new law: what is a "nonprofit" association? (The model Act leaves the question of for-profit associations to the side.)

The perfect did not thwart the good, however. In 1996, NCCUSL promulgated an Act. It does solve many problems, just not all of them. Twelve states have adopted it. In 1998, the North Carolina General Statutes Commission took up the NCCUSL model. By 2005 though, it still had done nothing. Then, prompted by the interest of some large associations, the General Assembly intervened. It told the painstaking and very deliberate Commission to get busy. Thus provoked, the Commission—with comments from the Business Law Section and others—proposed an Act which the General Assembly enacted in 2006 as Chapter 59B of the General Statutes. The North Carolina Act was effective on Jan. 1, 2007. It is not identical with NCCUSL's version, but it is close. It is accompanied by both Official Comments and North Carolina Comments.

The North Carolina Uniform Unincorporated Nonprofit Associations Act

After Jan. 1, 2007, North Carolina's nonprofit associations are no longer airy nothings. They exist. Chapter 59B firmly establishes nonprofit associations as entities (sort of). No one is required to do anything, or to change any procedures. Instead, the Act unilaterally awards the status of "entity" and creates new, entirely voluntary, possibilities for interested nonprofit groups. There are no registration or filing requirements, no fees to pay, and no mandatory form of organization or rules about how to operate.
In a nutshell,

- *Property*. Nonprofit associations can, if they wish to, receive, hold and transfer real and personal property in their own names and separately from their members.

- *Liability*. Members and agents of nonprofit associations are not automatically or vicariously liable for actions or legal obligations of the group.

- *Lawsuits*. Nonprofit associations can sue and be sued as associations, in their own names.

- *Inactive groups*. A procedure is provided for disposing of property of inactive associations.

- *Agent for service of process*. Associations that elect to do so may designate an agent for service of process.

The Act addresses only "external" relationships of nonprofit associations: property, legal obligations and lawsuits. It does not address internal matters: governance, control or rights among members.

Issues and Provisions of the Act

The Act presents the following issues for nonprofit associations, their members and those who deal with them.

What is an "unincorporated nonprofit association"?

The essence of the Act is that it gives to certain groups some of the attributes of corporations, even though they are not incorporated or registered with the State. Qualifying groups are treated as entities. Groups that qualify for this treatment are referred to in the statute as "nonprofit associations." A "nonprofit association" is defined as an unincorporated organization, other than one created by a trust and other than a limited liability company, consisting of two or more members joined by mutual consent for a common, nonprofit purpose.

The group must be "unincorporated," but in some fashion must be an "organization." This is to say that in some rudimentary way, a group must act like an entity in order to be treated like one. Joint tenancies, tenancies in common, and tenancies by the entireties are not by themselves nonprofit associations, even if the co-owners share use of property for nonprofit purposes.

Many unincorporated associations elect to have trappings of incorporated entities: charters, bylaws, agreed rules of governance, official names, various officers and agents. None of these is required by the Act, however. There is no requirement that anything must be in writing, or that the

association have a name, or that its purpose must be stated anywhere or by any particular means.

All that is required is that at least two persons must agree to (or, at least go along with) some manner of "organization" for a common nonprofit purpose. This broad definition is intended to extend the benefits of the Act to the smallest, most informal and most temporary of groups, clubs, teams and classes.

N.C.G.S. Section 59B-2(2) and Official Comments 7 and 8.

What is a "nonprofit" association?

To say that the Act applies to "nonprofit associations" begs a significant question: what is a "nonprofit" association?" Surprisingly, the term is not defined in the Act. The statute applies only to "nonprofit associations" but does not say what "nonprofit" means.

The Official Comments observe that a common definition of "nonprofit" would provide that net gains do not inure to the benefit of members of a nonprofit association and that there could be no distributions to members; but this Act is intended to apply to some groups that might well distribute gains to members, such as unincorporated consumer cooperatives, or perhaps athletic conferences.

General legal authorities say that not-for-profit associations include voluntary organizations formed for moral, benevolent, social, patriotic, civic or political non-commercial purposes. Nonprofits organizations are commonly classified as public benefit, mutual benefit, or religious.

Without doubt, the Act applies to more than just charities. But exactly when, say, a mutual benefit association which makes distributions to its members ceases to be a nonprofit association and becomes a for-profit association, or partnership, is left for case-by-case determinations.

N.C.G.S. Section 59B-2(2) and Official Comments 7, 8 and 9.

Who is a "member" of a nonprofit association?

In informal groups, membership may not be well defined.

The Act is concerned with determining membership of nonprofit associations, but only for purposes of external relations, such as liabilities to third persons. With that in mind, the term "member" as used in the Act is defined to mean

A person who, under the rules or practices of a nonprofit association, may participate in the selection of persons authorized to manage the affairs of the nonprofit association or in the development of policy of the nonprofit association.

This definition extends the protections of the Act (i.e., insulation from personal liability) to virtually anyone who might otherwise be liable for obligations of nonprofit associations.

At the same time, many groups themselves award "membership" liberally, and label as "members" anyone who donates funds to the association perhaps, or signs a list or roster. Mere labeling does not make a person a "member" for purposes of the Act, however.

N.C.G.S. Section 59B-2(1) and Official Comments 1, 2 and 3.

Entities can be members of nonprofit associations

Nonprofit associations may have as members individuals, corporations and all manner of other public and private legal entities.

N.C.G.S. Sections 59B-2(1) and 59B-2(3) and Official Comment 4.

Governance of nonprofit associations not covered

The Act seeks only to address external relations of nonprofit associations. It does not prescribe rules of governance or internal procedures of any kind. It says nothing about how decisions are made, how agents or officers are selected, who members may be, or what the association does. Most groups address those matters somehow: either with explicit agreements such as bylaws, or by consent of the members. Whether they do or not, questions about these matters must be resolved by general principles of law and equity because the Act does not address them.

N.C.G.S. Section 59B-3 and Official Comment.

Holding and transferring property

No longer are nonprofit associations ghosts. Under the Act, they exist. (At least, they exist to the extent that any legal entity exists, which is to say mostly in the minds of lawyers.) Nonprofit associations are legal entities for purposes of acquiring, holding and transferring real and personal property.

They can be beneficiaries, legatees and devisees. Judgments and executions can be entered against them and visited upon them like any other entity. They can own land and automobiles, have bank accounts and trade stock. This is true even for associations that have no connection to North

Carolina, except holding property here.

The Act's new provisions replace, and are consistent with similar provisions formerly set out in Chapter 39 of the General Statutes.

A new provision enables nonprofit associations to record in the offices of registers of deeds affidavits that authorize identified persons to transfer real property on their behalf.

N.C.G.S. Sections 59B-4, 59B-5, 59B-6 and Official Comments.

Liability of members and others

Just as nonprofit association are made legal entities for purposes of holding property, they are also entities separate from their members for purposes of determining and enforcing legal rights, duties and liabilities. This means that members and persons who participate in the management of associations, like shareholders and officers of corporations, are not liable, either directly or vicariously, for the associations' obligations merely by reason of their membership or participation in management. Also, consistently with the separation between associations and members, members may sue associations, and associations may sue their members.

N.C.G.S. Section 59B-7.

Lawsuits, proceedings, judgments, service of process, venue, standing, diversity of citizenship

Nonprofit associations can sue and be sued in their own names. Judgments or orders against associations do not automatically apply to members. Associations can appoint and file in the office of the Secretary of State a statement identifying an agent to receive service of process. Venue is proper in counties where associations have offices or places of operation, or where any officer resides if the association has no office or place of operation.

Importantly for many types of associations, associations have standing to assert claims on behalf of their members and persons it refers to as members, if the rights asserted are germane to the association's purposes. There is an extensive body of federal decisions about the status of unincorporated associations for venue and diversity purposes. Whether past rules will hold in the future will await future decisions of the federal courts.

N.C.G.S. Sections 59B-8, 59B-9, 59B-11, 59B-13; 73 Tul. L. Rev. 699 (1998); 4 Stan. L. Rev. 160 (1951).

Personal property of inactive associations

Where an association has been inactive for three years or more, a person in possession or control of personal property belonging to the association may transfer custody of the property to a person specified for that purpose in the association's documents, or if no person is specified, then either to a nonprofit entity pursuing broadly similar purposes, or to a government agency. The association's document may specify a period different than three years.

The term "inactive" is not defined. There is no requirement that an association must be dissolved. "Inactive" is understood merely to indicate that the association has stopped operating.

The provision for transferring property of inactive associations applies only to personal property, not real estate. It authorizes transfer of "custody," not title. Upon transfer, the property remains dedicated to the purpose for which the defunct association held it.

N.C.G.S. Section 59B-10 and Official Comment.

Names of associations

Under the Act, nonprofit associations are "entities." This means that they can hold property, make contracts, and sue-and-be-sued "in their own names." The nature of many informal groups though is that they have no names. The Act requires no names and provides no place to record one. (In the past, associations were covered by the assumed name statute G.S. Section 66-68, but Chapter 59B removed nonprofit associations from Section 66-68, which is itself obsolete in several respects.) This leaves a modest gap. It can be managed readily enough by careful legal practitioners but it may confound the unwary from time to time.

Effect of Act on existing relationships

The Act does not affect rights accrued before the new statutes become effective.

Deeds executed before the effective date in conformity with Sections 39-24 and 39-25 are declared to be sufficient to pass title to real estate. The Act does not affect conveyances of land by trustees of churches under Chapter 61 where the land is conveyed to and held by the trustees.

N.C.G.S. Section 59B-15; 2005 Sess. L. 2006-226, Section 2(b).

New Entity in Town

New Chapter 59B makes a new place for nonprofit associations in the continuum of legal persons

—even if the statute does not say exactly what a nonprofit association is, and even though it does not tie up every loose end.

Its rules will bring clarity to the external relations of groups that often have no sense of themselves as legal persons at all. And it creates a choice—an "entity" or "quasi entity," at least—for groups that either cannot afford to incorporate, or have no appetite for the rules associated with incorporating, or do not want to make their existence a matter of public record.

Cultural gurus predict many such groups to come in the flat, interconnected world of the future.

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PEOPLE

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