Prof.Conduct, Rule 3-100

Rule 3-100. Confidential Information of a Client

Currentness

(A) A member shall not reveal information protected from disclosure by Business and Professions Code section 6068, subdivision (e)(1) without the informed consent of the client, or as provided in paragraph (B) of this rule.

(B) A member may, but is not required to, reveal confidential information relating to the representation of a client to the extent that the member reasonably believes the disclosure is necessary to prevent a criminal act that the member reasonably believes is likely to result in death of, or substantial bodily harm to, an individual.

(C) Before revealing confidential information to prevent a criminal act as provided in paragraph (B), a member shall, if reasonable under the circumstances:

(1) make a good faith effort to persuade the client: (i) not to commit or to continue the criminal act or (ii) to pursue a course of conduct that will prevent the threatened death or substantial bodily harm; or do both (i) and (ii); and

(2) inform the client, at an appropriate time, of the member's ability or decision to reveal information as provided in paragraph (B).

(D) In revealing confidential information as provided in paragraph (B), the member's disclosure must be no more than is necessary to prevent the criminal act, given the information known to the member at the time of the disclosure.

(E) A member who does not reveal information permitted by paragraph (B) does not violate this rule.

DISCUSSION

[1] Duty of confidentiality. Paragraph (A) relates to a member's obligations under Business and Professions Code section 6068, subdivision (e)(1), which provides it is a duty of a member: “To maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client.” A member's duty to preserve the confidentiality of client information involves public policies of paramount importance. (In Re Jordan (1974) 12 Cal.3d 575, 580 [116 Cal.Rptr. 371].) Preserving the confidentiality of client information contributes to the trust that is the hallmark of the client-lawyer relationship. The client is thereby encouraged to seek legal assistance and to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter. The lawyer needs this information to represent the client effectively and, if necessary, to advise the client to refrain from wrongful conduct. Almost without exception, clients come to lawyers in order to determine their rights and what is, in the complex of laws and regulations, deemed to be legal and
correct. Based upon experience, lawyers know that almost all clients follow the advice given, and the law is upheld. Paragraph (A) thus recognizes a fundamental principle in the client-lawyer relationship that, in the absence of the client’s informed consent, a member must not reveal information relating to the representation. (See, e.g., Commercial Standard Title Co. v. Superior Court (1979) 92 Cal.App.3d 934, 945 [155 Cal.Rptr.393].)

[2] Client-lawyer confidentiality encompasses the attorney-client privilege, the work-product doctrine and ethical standards of confidentiality. The principle of client-lawyer confidentiality applies to information relating to the representation, whatever its source, and encompasses matters communicated in confidence by the client, and therefore protected by the attorney-client privilege, matters protected by the work product doctrine, and matters protected under ethical standards of confidentiality, all as established in law, rule and policy. (See In the Matter of Johnson (Rev. Dept. 2000) 4 Cal. State Bar Ct. Rptr. 179; Goldstein v. Lees (1975) 46 Cal.App.3d 614 [120 Cal.Rptr. 253].) The attorney-client privilege and work-product doctrine apply in judicial and other proceedings in which a member may be called as a witness or be otherwise compelled to produce evidence concerning a client. A member's ethical duty of confidentiality is not so limited in its scope of protection for the client-lawyer relationship of trust and prevents a member from revealing the client's confidential information even when not confronted with such compulsion. Thus, a member may not reveal such information except with the consent of the client or as authorized or required by the State Bar Act, these rules, or other law.

[3] Narrow exception to duty of confidentiality under this Rule. Notwithstanding the important public policies promoted by lawyers adhering to the core duty of confidentiality, the overriding value of life permits disclosures otherwise prohibited under Business & Professions Code section 6068(e), subdivision (1). Paragraph (B), which restates Business and Professions Code section 6068, subdivision (e)(2), identifies a narrow confidentiality exception, absent the client's informed consent, when a member reasonably believes that disclosure is necessary to prevent a criminal act that the member reasonably believes is likely to result in the death of, or substantial bodily harm to an individual. Evidence Code section 956.5, which relates to the evidentiary attorney-client privilege, sets forth a similar express exception. Although a member is not permitted to reveal confidential information concerning a client's past, completed criminal acts, the policy favoring the preservation of human life that underlies this exception to the duty of confidentiality and the evidentiary privilege permits disclosure to prevent a future or ongoing criminal act.

[4] Member not subject to discipline for revealing confidential information as permitted under this Rule. Rule 3-100, which restates Business and Professions Code section 6068, subdivision (e)(2), reflects a balancing between the interests of preserving client confidentiality and of preventing a criminal act that a member reasonably believes is likely to result in death or substantial bodily harm to an individual. A member who reveals information as permitted under this rule is not subject to discipline.

[5] No duty to reveal confidential information. Neither Business and Professions Code section 6068, subdivision (e)(2) nor this rule imposes an affirmative obligation on a member to reveal information in order to prevent harm. (See rule 1-100(A).) A member may decide not to reveal confidential information. Whether a member chooses to reveal confidential information as permitted under this rule is a matter for the individual member to decide, based on all the facts and circumstances, such as those discussed in paragraph [6] of this discussion.

[6] Deciding to reveal confidential information as permitted under paragraph (B). Disclosure permitted under paragraph (B) is ordinarily a last resort, when no other available action is reasonably likely to prevent the criminal act. Prior to revealing information as permitted under paragraph (B), the member must, if reasonable under the circumstances, make a good faith effort to persuade the client to take steps to avoid the criminal act or threatened harm. Among the factors to be considered in determining whether to disclose confidential information are the following:
(1) the amount of time that the member has to make a decision about disclosure;

(2) whether the client or a third party has made similar threats before and whether they have ever acted or attempted to act upon them;

(3) whether the member believes the member's efforts to persuade the client or a third person not to engage in the criminal conduct have or have not been successful;

(4) the extent of adverse effect to the client's rights under the Fifth, Sixth and Fourteenth Amendments of the United States Constitution and analogous rights and privacy rights under Article 1 of the Constitution of the State of California that may result from disclosure contemplated by the member;

(5) the extent of other adverse effects to the client that may result from disclosure contemplated by the member; and

(6) the nature and extent of information that must be disclosed to prevent the criminal act or threatened harm.

A member may also consider whether the prospective harm to the victim or victims is imminent in deciding whether to disclose the confidential information. However, the imminence of the harm is not a prerequisite to disclosure and a member may disclose the information without waiting until immediately before the harm is likely to occur.

[7] Counseling client or third person not to commit a criminal act reasonably likely to result in death of substantial bodily harm. Subparagraph (C)(1) provides that before a member may reveal confidential information, the member must, if reasonable under the circumstances, make a good faith effort to persuade the client not to commit or to continue the criminal act, or to persuade the client to otherwise pursue a course of conduct that will prevent the threatened death or substantial bodily harm, or if necessary, do both. The interests protected by such counseling is the client's interest in limiting disclosure of confidential information and in taking responsible action to deal with situations attributable to the client. If a client, whether in response to the member's counseling or otherwise, takes corrective action--such as by ceasing the criminal act before harm is caused--the option for permissive disclosure by the member would cease as the threat posed by the criminal act would no longer be present. When the actor is a nonclient or when the act is deliberate or malicious, the member who contemplates making adverse disclosure of confidential information may reasonably conclude that the compelling interests of the member or others in their own personal safety preclude personal contact with the actor. Before counseling an actor who is a nonclient, the member should, if reasonable under the circumstances, first advise the client of the member's intended course of action. If a client or another person has already acted but the intended harm has not yet occurred, the member should consider, if reasonable under the circumstances, efforts to persuade the client or third person to warn the victim or consider other appropriate action to prevent the harm. Even when the member has concluded that paragraph (B) does not permit the member to reveal confidential information, the member nevertheless is permitted to counsel the client as to why it may be in the client's best interest to consent to the attorney's disclosure of that information.

[8] Disclosure of confidential information must be no more than is reasonably necessary to prevent the criminal act. Under paragraph (D), disclosure of confidential information, when made, must be no more extensive than the member reasonably believes necessary to prevent the criminal act. Disclosure should allow access to the confidential information to only those persons who the member reasonably believes can act to prevent the harm. Under some circumstances, a member may determine that the best course to pursue is to make an anonymous disclosure to the potential victim or relevant law-enforcement authorities. What particular measures are reasonable depends on the circumstances known to the member. Relevant circumstances include
the time available, whether the victim might be unaware of the threat, the member’s prior course of dealings with
the client, and the extent of the adverse effect on the client that may result from the disclosure contemplated
by the member.

[9] Informing client of member's ability or decision to reveal confidential information under subparagraph (C)
(2). A member is required to keep a client reasonably informed about significant developments regarding
the employment or representation. Rule 3-500; Business and Professions Code, section 6068, subdivision (m).
Paragraph (C)(2), however, recognizes that under certain circumstances, informing a client of the member's
ability or decision to reveal confidential information under paragraph (B) would likely increase the risk of
death or substantial bodily harm, not only to the originally-intended victims of the criminal act, but also
to the client or members of the client's family, or to the member or the member's family or associates.
Therefore, paragraph (C)(2) requires a member to inform the client of the member's ability or decision to reveal
confidential information as provided in paragraph (B) only if it is reasonable to do so under the circumstances.
Paragraph (C)(2) further recognizes that the appropriate time for the member to inform the client may vary
depending upon the circumstances. (See paragraph [10] of this discussion.) Among the factors to be considered
in determining an appropriate time, if any, to inform a client are:

(1) whether the client is an experienced user of legal services;

(2) the frequency of the member's contact with the client;

(3) the nature and length of the professional relationship with the client;

(4) whether the member and client have discussed the member's duty of confidentiality or any exceptions to
that duty;

(5) the likelihood that the client's matter will involve information within paragraph (B);

(6) the member's belief, if applicable, that so informing the client is likely to increase the likelihood that a
criminal act likely to result in the death of, or substantial bodily harm to, an individual; and

(7) the member's belief, if applicable, that good faith efforts to persuade a client not to act on a threat have failed.

[10] Avoiding a chilling effect on the lawyer-client relationship. The foregoing flexible approach to the member's
informing a client of his or her ability or decision to reveal confidential information recognizes the concern
that informing a client about limits on confidentiality may have a chilling effect on client communication.
(See Discussion paragraph [11].) To avoid that chilling effect, one member may choose to inform the client of
the member's ability to reveal information as early as the outset of the representation, while another member
may choose to inform a client only at a point when that client has imparted information that may fall under
paragraph (B), or even choose not to inform a client until such time as the member attempts to counsel the
client as contemplated in Discussion paragraph [7]. In each situation, the member will have discharged properly
the requirement under subparagraph (C)(2), and will not be subject to discipline.

[11] Informing client that disclosure has been made; termination of the lawyer-client relationship. When a member
has revealed confidential information under paragraph (B), in all but extraordinary cases the relationship
between member and client will have deteriorated so as to make the member's representation of the client
impossible. Therefore, the member is required to seek to withdraw from the representation (see rule 3-700(B)),
unless the member is able to obtain the client's informed consent to the member's continued representation.
The member must inform the client of the fact of the member's disclosure unless the member has a compelling
interest in not informing the client, such as to protect the member, the member's family or a third person from the risk of death or substantial bodily harm.

[12] Other consequences of the member's disclosure. Depending upon the circumstances of a member's disclosure of confidential information, there may be other important issues that a member must address. For example, if a member will be called as a witness in the client's matter, then rule 5-210 should be considered. Similarly, the member should consider his or her duties of loyalty and competency (rule 3-110).

[13] Other exceptions to confidentiality under California law. Rule 3-100 is not intended to augment, diminish, or preclude reliance upon, any other exceptions to the duty to preserve the confidentiality of client information recognized under California law.

Credits
(Adopted, eff. July 1, 2004.)

Notes of Decisions (1)
Prof. Conduct, Rule 3-100, CA ST RPC Rule 3-100
California Rules of Court, California Rules of Professional Conduct, and California Code of Judicial Ethics are current with amendments received through August 1, 2017. California Supreme Court, California Courts of Appeal, Guidelines for the Commission of Judicial Appointments, Commission on Judicial Performance, and all other Rules of the State Bar of California are current with amendments received through August 1, 2017.
Rule 3-110. Failing to Act Competently, CA ST RPC Rule 3-110

West's Annotated California Codes
Rules of the State Bar of California (Refs & Annos)
California Rules of Professional Conduct (Refs & Annos)
Chapter 3. Professional Relationship with Clients

Prof.Conduct, Rule 3-110

Rule 3-110. Failing to Act Competently

Currentness

(A) A member shall not intentionally, recklessly, or repeatedly fail to perform legal services with competence.

(B) For purposes of this rule, “competence” in any legal service shall mean to apply the 1) diligence, 2) learning and skill, and 3) mental, emotional, and physical ability reasonably necessary for the performance of such service.

(C) If a member does not have sufficient learning and skill when the legal service is undertaken, the member may nonetheless perform such services competently by 1) associating with or, where appropriate, professionally consulting another lawyer reasonably believed to be competent, or 2) by acquiring sufficient learning and skill before performance is required.

DISCUSSION


In an emergency a lawyer may give advice or assistance in a matter in which the lawyer does not have the skill ordinarily required where referral to or consultation with another lawyer would be impractical. Even in an emergency, however, assistance should be limited to that reasonably necessary in the circumstances.

Credits

Notes of Decisions (90)

Prof. Conduct, Rule 3-110, CA ST RPC Rule 3-110
California Rules of Court, California Rules of Professional Conduct, and California Code of Judicial Ethics are current with amendments received through August 1, 2017. California Supreme Court, California Courts of Appeal, Guidelines for the Commission of Judicial Appointments, Commission on Judicial Performance, and all other Rules of the State Bar of California are current with amendments received through August 1, 2017.
Rule 3-300. Avoiding Interests Adverse to a Client, CA ST RPC Rule 3-300

Prof.Conduct, Rule 3-300

Rule 3-300. Avoiding Interests Adverse to a Client

Currentness

A member shall not enter into a business transaction with a client; or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

(A) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client; and

(B) The client is advised in writing that the client may seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

(C) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.

DISCUSSION

Rule 3-300 is not intended to apply to the agreement by which the member is retained by the client, unless the agreement confers on the member an ownership, possessory, security, or other pecuniary interest adverse to the client. Such an agreement is governed, in part, by rule 4-200.

Rule 3-300 is not intended to apply where the member and client each make an investment on terms offered to the general public or a significant portion thereof. For example, rule 3-300 is not intended to apply where A, a member, invests in a limited partnership syndicated by a third party. B, A's client, makes the same investment. Although A and B are each investing in the same business, A did not enter into the transaction “with” B for the purposes of the rule.

Rule 3-300 is intended to apply where the member wishes to obtain an interest in client's property in order to secure the amount of the member's past due or future fees.

Credits

Notes of Decisions (88)

Prof. Conduct, Rule 3-300, CA ST RPC Rule 3-300
California Rules of Court, California Rules of Professional Conduct, and California Code of Judicial Ethics are current with amendments received through August 1, 2017. California Supreme Court, California Courts of Appeal, Guidelines for the Commission of Judicial Appointments, Commission on Judicial Performance, and all other Rules of the State Bar of California are current with amendments received through August 1, 2017.
Rule 3-310. Avoiding the Representation of Adverse Interests, CA ST RPC Rule 3-310

Prof.Conduct, Rule 3-310

Rule 3-310. Avoiding the Representation of Adverse Interests

Currentness

(A) For purposes of this rule:

(1) “Disclosure” means informing the client or former client of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the client or former client;

(2) “Informed written consent” means the client's or former client's written agreement to the representation following written disclosure;

(3) “Written” means any writing as defined in Evidence Code section 250.

(B) A member shall not accept or continue representation of a client without providing written disclosure to the client where:

(1) The member has a legal, business, financial, professional, or personal relationship with a party or witness in the same matter; or

(2) The member knows or reasonably should know that:

(a) the member previously had a legal, business, financial, professional, or personal relationship with a party or witness in the same matter; and

(b) the previous relationship would substantially affect the member's representation; or

(3) The member has or had a legal, business, financial, professional, or personal relationship with another person or entity the member knows or reasonably should know would be affected substantially by resolution of the matter; or

(4) The member has or had a legal, business, financial, or professional interest in the subject matter of the representation.

(C) A member shall not, without the informed written consent of each client:
(1) Accept representation of more than one client in a matter in which the interests of the clients potentially conflict; or

(2) Accept or continue representation of more than one client in a matter in which the interests of the clients actually conflict; or

(3) Represent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter.

(D) A member who represents two or more clients shall not enter into an aggregate settlement of the claims of or against the clients without the informed written consent of each client.

(E) A member shall not, without the informed written consent of the client or former client, accept employment adverse to the client or former client where, by reason of the representation of the client or former client, the member has obtained confidential information material to the employment.

(F) A member shall not accept compensation for representing a client from one other than the client unless:

(1) There is no interference with the member's independence of professional judgment or with the client-lawyer relationship; and

(2) Information relating to representation of the client is protected as required by Business and Professions Code section 6068, subdivision (e); and

(3) The member obtains the client's informed written consent, provided that no disclosure or consent is required if:

(a) such nondisclosure is otherwise authorized by law; or

(b) the member is rendering legal services on behalf of any public agency which provides legal services to other public agencies or the public.

DISCUSSION
Rule 3-310 is not intended to prohibit a member from representing parties having antagonistic positions on the same legal question that has arisen in different cases, unless representation of either client would be adversely affected.

Other rules and laws may preclude making adequate disclosure under this rule. If such disclosure is precluded, informed written consent is likewise precluded. (See, e.g., Business and Professions Code section 6068, subdivision (e).)
Paragraph (B) is not intended to apply to the relationship of a member to another party's lawyer. Such relationships are governed by rule 3-320.

Paragraph (B) is not intended to require either the disclosure of the new engagement to a former client or the consent of the former client to the new engagement. However, both disclosure and consent are required if paragraph (E) applies.

While paragraph (B) deals with the issues of adequate disclosure to the present client or clients of the member's present or past relationships to other parties or witnesses or present interest in the subject matter of the representation, paragraph (E) is intended to protect the confidences of another present or former client. These two paragraphs are to apply as complementary provisions.

Paragraph (B) is intended to apply only to a member's own relationships or interests, unless the member knows that a partner or associate in the same firm as the member has or had a relationship with another party or witness or has or had an interest in the subject matter of the representation.

Subparagraphs (C)(1) and (C)(2) are intended to apply to all types of legal employment, including the concurrent representation of multiple parties in litigation or in a single transaction or in some other common enterprise or legal relationship. Examples of the latter include the formation of a partnership for several partners or a corporation for several shareholders, the preparation of an ante-nuptial agreement, or joint or reciprocal wills for a husband and wife, or the resolution of an “uncontested” marital dissolution. In such situations, for the sake of convenience or economy, the parties may well prefer to employ a single counsel, but a member must disclose the potential adverse aspects of such multiple representation (e.g., Evid. Code, § 962) and must obtain the informed written consent of the clients thereto pursuant to subparagraph (C)(1). Moreover, if the potential adversity should become actual, the member must obtain the further informed written consent of the clients pursuant to subparagraph (C)(2).

Subparagraph (C)(3) is intended to apply to representations of clients in both litigation and transactional matters.

In State Farm Mutual Automobile Insurance Company v. Federal Insurance Company (1999) 72 Cal.App.4th 1422 [86 Cal.Rptr.2d 20], the court held that subparagraph (C)(3) was violated when a member, retained by an insurer to defend one suit, and while that suit was still pending, filed a direct action against the same insurer in an unrelated action without securing the insurer's consent. Notwithstanding State Farm, subparagraph (C)(3) is not intended to apply with respect to the relationship between an insurer and a member when, in each matter, the insurer's interest is only as an indemnity provider and not as a direct party to the action.

There are some matters in which the conflicts are such that written consent may not suffice for non-disciplinary purposes. (See Woods v. Superior Court (1983) 149 Cal.App.3d 931 [197 Cal.Rptr. 185]; Klemm v. Superior Court (1977) 75 Cal.App.3d 893 [142 Cal.Rptr. 509]; Ishmael v. Millington (1966) 241 Cal.App.2d 520 [50 Cal.Rptr. 592].)

Paragraph (D) is not intended to apply to class action settlements subject to court approval.

Paragraph (F) is not intended to abrogate existing relationships between insurers and insureds whereby the insurer has the contractual right to unilaterally select counsel for the insured, where there is no conflict of interest. (See San Diego Navy Federal Credit Union v. Cumis Insurance Society (1984) 162 Cal.App.3d 358 [208 Cal.Rptr. 494].)
Rule 3-310. Avoiding the Representation of Adverse Interests, CA ST RPC Rule 3-310

Credits

Notes of Decisions (916)

Prof. Conduct, Rule 3-310, CA ST RPC Rule 3-310
California Rules of Court, California Rules of Professional Conduct, and California Code of Judicial Ethics are current with amendments received through August 1, 2017. California Supreme Court, California Courts of Appeal, Guidelines for the Commission of Judicial Appointments, Commission on Judicial Performance, and all other Rules of the State Bar of California are current with amendments received through August 1, 2017.
The Model Rules of Professional Conduct do not prohibit a lawyer from serving as a director of a corporation while simultaneously serving as its legal counsel, but there are ethical concerns that a lawyer occupying the dual role of director and legal counsel should consider. The lawyer should reasonably assure at the outset of the dual relationship that management and the other board members understand the different responsibilities of legal counsel and director; understand that in some circumstances matters discussed at board meetings with the lawyer in her role as director will not receive the protection of the attorney-client privilege; and understand that conflicts of interest could arise requiring the lawyer to recuse herself as a director or to decline representation of the corporation in a matter. During the dual relationship, the lawyer should exercise reasonable care to protect the corporation’s confidential information and to confront and resolve conflicts of interest that arise. From the discussion of these ethical concerns, the Committee derives general guidelines that a lawyer, once having agreed to serve on the board of a corporate client, should follow in order to minimize the risk of violations of the Model Rules.

The Committee addresses in this opinion the propriety of a lawyer serving on the board of directors of a corporation that she or her firm represents as counsel.\(^1\)

---

\(^1\) The opinion has been prompted by the work of the Task Force on the Independent Lawyer of the Section of Litigation, which has been studying the role of lawyers serving as directors of their clients. See *The Lawyer-Director: Implications for Independence* (TASK FORCE ON THE INDEPENDENT LAWYER, A.B.A. SEC. LITIGATION, March 1998). *See also* Report of the Commission on Professionalism to the Board of Governors and the House of Delegates of the American Bar Association, *In the Spirit of Public Service: A Blueprint for the Rekindling of Lawyer Professionalism*, reprinted at 112 F.R.D. 243, 280-81 (1986) (identifying three areas of special concern for the legal profession and recommending further analysis by the bar, including lawyers serving on their clients’ boards, lawyers investing in their clients’ businesses and transactions, and lawyers’ ancillary business activities).
Although some commentators have urged that the practice be prohibited, the Model Rules of Professional Conduct (1983) (amended 1997) contain no such prohibition, but only a cautionary Comment that states:

A lawyer for a corporation or other organization who is also a member of its board of directors should determine whether the responsibilities of the two roles may conflict. The lawyer may be called on to advise the corporation in matters involving actions of the directors. Consideration should be given to the frequency with which such situations may arise, the potential intensity of the conflict, the effect of the lawyer’s resignation from the board and the possibility of the corporation’s obtaining legal advice from another lawyer in such situations. If there is material risk that the dual role will compromise the lawyer’s independence of professional judgment while acting as counsel, the lawyer should not serve as a director.

The Committee is aware that it is common for lawyers to be invited to serve on the boards of directors of their clients. As the Rule 1.7 Comment suggests, ethical problems can arise when a lawyer serves as a member of the board of directors of a client. Because the Comment does not offer detailed guidance, the Committee in this Opinion discusses the problems a lawyer faces when serving in this dual role and suggests some measures that a lawyer should take in order to minimize the risk of Model Rules violations.

2. See, e.g., Dennis R. Block, George F. Meierhofer Jr. & Daniel L. Wallach, Lawyers Serving on the Boards of Directors of Clients: A Survey of the Problems, PRENTICE HALL LAW & BUS. INSIGHTS, April 1993, at 3 (“an outright prohibition on the practice would be appropriate”); Monroe Freedman, You CAN Do It, But You SHOULdn’t, AMERICAN LAWYER, Dec. 1992, at 43; Martin Riger, The Lawyer-Director—“A Vexing Problem,” 33 BUS. LAW. 2381 (1978); CHARLES W. WOLFRAM, MODERN LEGAL ETHICS 738-40 (1986) (“[a]t least the practice of serving as both counsel and director for a large corporate client is unsound and should be prohibited by law”). But see Craig C. Albert, The Lawyer-Director: An Oxymoron?, 9 GEO. J. LEGAL ETHICS 413 (1996) (concluding that prohibiting dual service in all circumstances is detrimental to clients’ interests and both unwise and unnecessary).

3. Model Rule 1.7 Comment [14]. See also RESTATEMENT OF THE LAW GOVERNING LAWYERS §216, Comment d (Proposed Final Draft No. 1, March 29, 1996) (The dual relationship is permissible. “However, when the obligations or personal interests as director are materially adverse to those of the lawyer as corporate counsel, the lawyer may not continue to serve as corporate counsel without the informed consent of the corporate client. The lawyer may not participate as director or officer in the decision to grant consent.”) During consideration of the Model Rules, the Kutak Commission viewed the dual role with ambivalence, initially approving lawyers’ service on clients’ boards only upon consent of all those having an interest in the enterprise. See January 25, 1979 Kutak Interim Revised Draft, Rule 1.12(e). The next draft allowed service as a director by lawyers who also are counsel for the corporation only (1) with approval of “all persons having an investment interest in the organization,” and (2) when there was no “serious risk of conflict between the lawyer’s responsibilities as general counsel and those as a director”, apparently exempting from these requirements a lawyer whose “representation is occasional or limited to specific matters.” See January 30, 1979 Kutak Discussion Draft, Rule 1.9(f) and Comment.
We emphasize that not every lawyer will confront the same ethical challenges when serving as a member of a client’s board of directors. The issues to be faced will differ depending on the nature of the legal services to be provided by the lawyer-director or her firm, the nature of the client’s business, and the nature of the representation which could range from serving as general counsel to handling a few discrete transactions. Thus, the advice that follows is general in nature and does not attempt to reflect the specific facts of every contemplated dual relationship.

The issues raised when a lawyer serves concurrently as corporate director and counsel are analyzed here in the following sections: (1) Advising the corporate management and board when the dual role commences; (2) Protecting confidences and the attorney-client privilege; and (3) Confronting and resolving conflicts and other ethical issues that arise in the course of the dual relationship. This analysis is followed by a Summary where good practice guidelines are enumerated.

I. Advice to Clients Regarding the Dual Role

There are several broad categories of ethical concerns that exist when corporate counsel agrees to serve as director of her corporate client: (1) concerns that conflicts of interest will arise, causing reasonable parties to question the lawyer’s professional independence and sometimes requiring the lawyer-director to decline representation in a matter or resign as a director; (2) concerns that the lawyer, when acting solely as a corporate director, the lawyer’s firm to vicarious liability resulting from the lawyer’s actions as a director, especially in securities offerings; and (5) increased likelihood of disqualification from representing the corporation in litigation. See Karen L. Valihura and Micalyn S. Harris, Avoiding Pitfalls That Might Arise When Your Outside Counsel Serves as a Director and Attorneys Liability Assurance Society, Inc., Entrepreneurial Activities, both reprinted in The Lawyer as Director of a Client, A.B.A. SEC. BUS. LAW (August 4, 1997); Albert, supra note 2, at 449-471. These risks are likely to be increased substantially when the lawyer-director serves also as an executive officer of her corporate client, or where the lawyer serves as an executive officer, but not as a director of her corporate client.

5. The analysis assumes that, while serving as corporate counsel, the lawyer is asked to join the corporate board, but substantially the same analysis must be made when a lawyer-director who never has performed legal services for the corporation is asked to do so.

6. Independence concerns beyond those found in all lawyer-client relationships and governed by Model Rule 5.4 applicable to lawyer conduct generally are seen by
other directors, and management will be confused whether the lawyer’s views on a matter are legal advice or are expressed as the business or practical suggestions of a board member; and (3) concerns with protecting the confidentiality of client information, especially protecting the attorney-client privilege. While these concerns are real, many of the problems can be cured, or at least ameliorated, by full, free and frank discussions by the lawyer with the corporation’s executives and the other board members. Ideally this discussion will occur before the lawyer becomes a board member. It is at this stage that the ethical lawyer should reasonably assure herself that those in authority understand the ethical and practical pitfalls that lie along the way. When in-house corporate counsel employed as a corporate executive is available, a discussion with him often will suffice. In other situations, the lawyer should take the time to explain the risks to the executive officers and other board members herself.

The explanation should describe the potential for conflicts of interest and how they might disable the lawyer from acting as either a director or a lawyer at some particularly critical time or require safeguards, such as engaging the services of counsel other than the lawyer or her firm. Similarly, the lawyer also should reasonably assure herself that the possible threat to the attorney-client privilege and consequent disclosure of confidential information are understood, either by discussions with employed corporate counsel or with the executive officers and other board members. In situations where a substantial likelihood exists that a disabling conflict of interest will arise or that the attorney-client privilege will be lost in a pending matter, the lawyer should offer to continue as counsel, attend board meetings and preserve her role solely as corporate counsel until the risk abates.

If there is reasonable assurance that the client is informed of the potential issues that might arise and still wishes the lawyer to serve as a director, and if the lawyer concludes that no current disqualifying conflict of interest or other ethical impediment bars the dual role, then the lawyer may accept the directorship. This initial decision about the continuing role of lawyer as lawyer and lawyer as director must nevertheless be revisited as situations arise that call for further consultation with the client, and the lawyer may have to consider withdrawing from one position or the other if necessary. See infra Part III.

Because of the need for the lawyer and the corporation’s management and board to give ongoing attention to potential conflicts, attorney-client privilege protection and other issues that may arise as a result of the dual role, the lawyer-director should consider providing a written memorandum in addition to an oral explanation. A written memorandum is of particular assistance in describing the lawyer’s role as counsel for the corporate entity and not for its constituent officers or direc-

some commentators on the lawyer-director role as the proper province, not of disciplinary rules, but of corporate law and SEC rules. See, e.g., Robert H. Mundheim, Should Code of Professional Responsibility Forbid Lawyers to Serve on Boards of Corporation for Which They Act as Counsel, 33 BUS. LAW. 1507, 1510 (1978).

tors and in explaining the differences between serving as a director and serving as
counsel. It is, of course, imperative that any standards specified in such a written
memorandum be followed in practice.8

II. The Lawyer-Director Must Exercise Reasonable Care
to Protect the Corporation’s Attorney-Client Privilege

Lawyers serving as directors have the same obligation as other lawyers to main-
tain confidentiality and avoid compromising the attorney-client privilege of the
corporation. A lawyer’s duty of confidentiality under Model Rule 1.69 is consistent
with a director’s duty of confidentiality that arises from her role as a fiduciary for
the corporation, although the scope of these two duties is not precisely the same.

A problem arises, however, as the result of the inconsistent responsibilities of
director and lawyer in the application of the attorney-client evidentiary privilege.10
Because the lawyer-director provides the management and board with business
advice as well as legal assistance, the lawyer, management and board members
could find themselves forced to testify about conversations that would not be
involuntarily disclosed if the lawyer-director had been acting only as a lawyer.

Several cases analyzing the attorney-client privilege in the corporate context
strictly limit the subject matter protected by the privilege to purely legal advice
even when other considerations affect management’s decision, such as financial

8. For a sample of the issues that a memorandum might discuss, see Susan R.
PROFESSIONAL LAWYER, 1996 A.B.A. CTR. FOR PROF’L RESP. 113-114.

9. Rule 1.6 states:
(a) A lawyer shall not reveal information relating to representation of a client
unless the client consents after consultation, except for disclosures that are implied-
ly authorized in order to carry out the representation, and except as stated in para-
graph (b).
(b) A lawyer may reveal such information to the extent the lawyer reasonably
believes necessary:
(1) to prevent the client from committing a criminal act that the lawyer
believes is likely to result in imminent death or substantial bodily harm; or
(2) to establish a claim or defense on behalf of the lawyer in a controversy
between the lawyer and the client, to establish a defense to a criminal charge or
civil claim against the lawyer based upon conduct in which the client was
involved, or to respond to allegations in any proceeding concerning the
lawyer’s representation of the client.

10. The privilege exists:
(1) where legal advice of any kind is sought (2) from a professional legal advis-
er in his capacity as such, (3) the communications relating to that purpose, (4)
made in confidence (5) by the client, (6) are at his instance permanently protect-
ed (7) from the disclosure by himself or by the legal adviser, (8) except the pro-
tection be waived . . . .

8 Wigmore, Evidence §2295 p. 554 (1961 rev.). The privilege extends to communica-
tions of the type described between a lawyer and her corporate client. See
RESTATEMENT, supra note 3, §123 (Privilege for Organizational Client).
issues or corporate policy. The fact that the lawyer is a director also increases the chances that the privilege may be lost even for purely legal advice. More appropriately, other cases have analyzed the privilege applied to lawyer-director’s communications according to whether business or legal advice was sought. In these cases, a claim of privilege has been rejected only when the communications related to the provision of purely business advice.

Given the stricter limitations applied by some courts on the privilege for communications with a lawyer-director, it is vital that the lawyer who also serves as a director be particularly careful when her client’s management or board of directors consults her for legal advice. The lawyer-director should make clear that the meeting is solely for the purpose of providing legal advice. The lawyer should avoid the temptation of providing business or financial advice, except insofar as it affects legal considerations such as the application of the business judgment rule. When appropriate, the lawyer-director should have another member of her firm present at the meeting to provide the legal advice.

These procedures not only will provide the best support for a claim of privilege for the conversations, but also will alert board members who otherwise might mistakenly believe the lawyer-director is giving them business advice. The procedures also alert all involved to treat the information with the utmost care that normally is associated with confidential attorney-client communications.

11. See, e.g., United States v. Wilson, 798 F.2d 509, 573 (1st Cir. 1986) (no privilege because lawyer offered business advice); Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970), cert. denied, 401 U.S. 974 (1971) (narrowing scope of privilege of a corporation’s management vis-a-vis its shareholders); and Georgia Pacific Corporation v. GAF, 1996 U.S. Dist. Lexis 671 (S.D.N.Y. 1996) (denying privilege to in-house counsel about his recommendations to change contract provisions made to his client’s officers under circumstances where, as a negotiator of environmental provisions in a contract, most courts would apply the privilege to outside counsel).

12. For example, a few cases have held that when the lawyer becomes a director the privilege essentially evaporates. See Federal Savings & Loan Ins. Corp. v. Fielding, 343 F. Supp. 537, 546 (D. Nev. 1972) (“When the attorney and the client get in bed together as business partners, their relationship is a business relationship, not a professional one, and their confidences are business confidences unprotected by a professional privilege.”); In re Robinson, 125 N.Y.S. 193 (N.Y. App. Div. 1910) (“When the corporation made him a director . . . [it] removed him from the relation of attorney or counsel to its officers, so far as the corporate affairs were concerned.”).


14. Of course the customary measures to protect the privilege also should be taken. Corporate personnel outside the management group and all outsiders not essential to the legal advice should be excused from the meeting room. If regular minutes are prepared, they should reflect that the lawyer-director was consulted on a legal matter in executive session. Any minutes of the executive session should, along with all notes made by anyone present, be retained only in separate files marked “attorney-client privilege” and kept in a secure place. When written advice is to be protected, the memorandum should be limited to legal advice and be marked “attorney-client privilege.”
The lawyer-director also should bear in mind that, although only the client (or a lawyer acting with the client’s express consent) can waive the attorney-client privilege, the lawyer, because she also is director, may be found to have waived the privilege on behalf of the corporation without need of any further client consent. In *Vehicular Parking, supra* note 13, for example, the court found that a lawyer-director’s voluntary disclosure of memoranda to the government in an antitrust case effected a waiver of the lawyer-client privilege because he produced the documents in his role as a “business manager” and not while “wear[ing] his lawyer suit.”

Finally, a director, who also is the corporation’s lawyer, may be under a duty to disclose information to third parties (such as in response to an auditor’s request) that in her role as legal counsel to the corporation she could not disclose without specific consent.\(^{15}\) Acts of a lawyer-director and her knowledge as a director may prove inseparable from the lawyer’s acts and knowledge as member of a law firm. The director’s fiduciary obligations as a director and her professional obligations as a lawyer cannot “be placed in convenient separate boxes.”\(^{16}\) The knowledge of a corporate director and officer, with respect to transactions in which she is authorized to act, is imputed to the corporation. Similarly, the knowledge of a partner in a law firm gained during confidential relationships with clients is imputed to the other partners in the law firm. There is a risk in some circumstances that the files and work processes of the law firm could become as available for discovery as are the files and records of the corporation itself.\(^ {17}\)

### III. The Lawyer-Director Must Confront and Resolve Ethical Issues that Arise During the Dual Role

The lawyer-director must be alert to ethical issues that can arise during the course of the dual relationship. The potential issues addressed here are: (a) serving as counsel in a matter that she opposed as a director; (b) opining on past board actions in which the lawyer-director participated; (c) acting as a director in corporate actions affecting her as a lawyer or her law firm; and (d) representing the corporation in certain types of litigation.

\(^{15}\) A law firm normally responds to auditors asserting, in accordance with Auditor’s Letter Handbook, *Statement of Policy Regarding Lawyers’ Responses to Auditors’ Request for Information*, 31 Bus. Law. No. 3 (April 1976), that its engagement has been limited to specific matters and that there may exist other matters that could have a bearing on the company’s financial condition with respect to which the firm has not been consulted. As the guidelines state:

> Unless the lawyer’s response indicates otherwise, (a) it is properly limited to matters which have been given substantive attention by the lawyer in the form of legal consultation and, where appropriate, legal representation since the beginning of the period or periods being reported upon. . . .

When a lawyer in the law firm is a lawyer-director, however, the law firm should expand the disclaimer to exclude any information the law firm’s lawyer-director may have as a director.


\(^{17}\) See, e.g., *Deutsch v. Cogan*, 580 A.2d 100 (Del. Ch. 1990) (because of firm lawyer’s directorship, firm owed fiduciary duty to minority shareholders claiming injury in merger in which firm represented company).
A. Conflict in Pursuing Client Objectives that the Lawyer, as a Director, Opposed

An ethical issue arises when a lawyer-director is asked to represent the corporation in an undertaking that she, as a director, has unsuccessfully opposed. Should the lawyer undertake the representation? If the lawyer should not, may other lawyers in her law firm represent the corporation in the matter? Are there circumstances when the lawyer and her firm are precluded under the Model Rules from representing the corporation?

In this situation, the lawyer must determine whether her representation of the corporation may be “materially limited” by her opposition to the action the corporation has decided to undertake, such that Model Rule 1.7(b) applies. Generally, when a lawyer counsels any client against a given course of action, but the client rejects that advice, the client’s decision once made must be accepted by the lawyer. See Model Rule 1.13 Comment [3]. A lawyer by representing a client does not endorse “the client’s political, economic, social or moral views or activities.” Model Rule 1.2(b). And even after offering an opinion on such matters, it may be easy for a lawyer to conclude that, once the client has decided to pursue its chosen course, the lawyer can remain the lawyer for the client.

However, for the lawyer-director, who is required as a director to make a business judgment, this calculus may be different, a fact the lawyer should recognize before she undertakes representing the corporation in the matter. When a lawyer has participated in the decision-making as a client, there may be an increased risk that she will be tempted to “pull her punches” as she represents the corporation in going forward, or may be perceived by others as providing less than diligent representation. See Model Rule 1.3.

If representation of the corporation may be materially limited by these factors, the lawyer then must also determine whether she reasonably believes the representation will not be adversely affected. See Model Rule 1.7(b). If she reaches

---

18. Rule 1.7(b) states:

(b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer’s responsibilities to another client or to a third person, or by the lawyer’s own interests, unless:

(1) the lawyer reasonably believes the representation will not be adversely affected; and

(2) the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.


[A]lthough it is not professionally improper for a lawyer to serve as a director of a business corporation and also to represent that corporation . . . he must be unusually vigilant to assure that he never allows his business function as a director to infringe upon the legal advice given to, and the representation of his corporation client.
that conclusion, which applies objectively, and the client consents after consultation, then the lawyer is not disqualified from the representation. Even so, if the lawyer continues to believe that the corporation’s chosen course of action is imprudent, she may be unwise to undertake the representation personally; another lawyer in her firm would be permitted to represent the corporation under Model Rules 1.7(b) and 1.10(a).\textsuperscript{20}

If, however, the lawyer-director concludes that under Rule 1.7(b) she personally is disqualified, her conflict is imputed under Model Rule 1.10(a) to the rest of her firm’s lawyers, who also are disqualified from the representation. This could occur, for example, were she to conclude that she will face personal liability as a result of the course chosen by a majority of the directors over her objection. If so, she should consider resigning from the board if necessary for self-protection. Whether or not she resigns, the situation may create a nonconsentable conflict of interest under Rule 1.7(b) because the representation would be adversely affected, thus disqualifying her law firm as well as herself from the representation. This would be true even if the corporation’s actions are not criminal or fraudulent, see Model Rule 1.2(d), and do not violate a legal obligation owed by the directors or management to the corporation that is likely to result in substantial injury to it, see Model Rule 1.13(b).

\textbf{B. Conflict in Opining on Board Actions in which the Lawyer-Director Participated}

A lawyer who serves as a director could be disabled from rendering opinions or offering her best legal judgment with respect to a specific matter because of her role as a director. For example, when the lawyer-director is asked to provide advice to the corporation on matters involving prior actions of the board, such as whether an incentive pay arrangement is lawful, she may in effect be advising on the legality of actions in which she herself has participated as a director. Under these circumstances, it may prove difficult for the lawyer to speak independently as counsel to the corporation in light of her own interest as a director. See Rule 1.7(b). Moreover, seeking a waiver of the potential conflict is problematic because the very directors who would need to provide the waiver are themselves directly concerned by the question that is being raised. Finally, if the opinion is sought in order to justify an action the board currently has before it, the advice-of-counsel defense to a later lawsuit may be undermined by the lack of independence of the lawyer-director and her firm. In some cases these concerns

\begin{itemize}
\item \textsuperscript{20} Rule 1.10(a) states:
\begin{itemize}
\item (a) While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7, 1.8(c), 1.9 or 2.2.
\end{itemize}
When the lawyer-director recuses herself from personal choice because of a concern that her personal views might be seen by some to cause her to pursue the selected course less vigorously, Rule 1.7(b) is not implicated, and hence Rule 1.10(a) does not apply to bar others in her firm from representing the corporation in the matter. See also Model Rule 1.16(b)(3) (lawyer may withdraw if no material adverse effect on client’s interests when client pursues objective the lawyer considers repugnant or imprudent).
\end{itemize}
can be mitigated by the participation of other counsel to advise on the issue, without compelling the complete withdrawal of the lawyer-director as counsel.21

C. Conflict Regarding Corporate Actions
Affecting Lawyer or Her Firm

A conflict issue may also arise when a matter comes before the board of directors that will significantly affect the corporation’s use of lawyers. For example, the corporation might consider a major purchase or merger, an initial public offering, or launching a new product that requires major regulatory approval. Is the lawyer-director able to exercise sound business judgment as a director when participating in the board’s decision in circumstances where it is clear, e.g., that (i) her firm will be engaged to perform the legal services, or (ii) her firm will be a candidate to do so, or (iii) another firm will be engaged to perform the services?

The analysis here differs from the conflict regarding legal advice discussed above in Part IIIB. To the extent that the lawyer is taking action as a director, the question here is whether she is able to exercise independent judgment as a director when the board’s decision could significantly affect the director’s law firm. The lawyer-director should consider whether, under the law of corporate governance, she should recuse herself as a director from consideration of the matter, or remove her firm from consideration to perform the legal services, or both, or whether she may participate after noting to the other board members (or to employed corporate counsel) her personal interest and its potential effects.

To the extent the lawyer is acting as a lawyer, the law governing lawyers applies. The Association of the Bar of the City of New York Professional Ethics Committee has said:

The lawyer may not “tak[e] advantage of his or her position [as director] to procure professional employment for the lawyer or the lawyer’s law firm,” N.Y. State 589 (1988), or participate in the board’s decision to retain the lawyer, N.Y. City 611 (1942). Indeed, the lawyer-director may not participate “in any decision of the [board] that will or reasonably may affect the lawyer’s own personal or financial interests as counsel.” N.Y. State 589 (1988). Finally, the lawyer-director must exercise his or her independent professional judgment “solely for the benefit of [the corporation] and free of compromising influences and loyalties,” EC 5-1, that may arise out of his or her role as director (such as a desire to be re-elected to the board or concern for the lawyer’s personal liability as a director).22

We do not believe that New York’s blanket prohibition should apply to the situations just described. Nevertheless, the prudent lawyer should at a minimum abstain from voting as a director on issues which directly involve the relationship of the corporation with her law firm, such as issues of engagement, performance, payment or discharge.

21. The Restatement, supra note 3, Illustration 3, finds rendering opinions in these circumstances permissible with the informed consent of the corporation’s authorized agents, presumably the board of directors.
If the lawyer-director’s firm has been pre-selected to perform the services that will be necessary if the course of action is approved, the lawyer-director also should consider abstaining as a director from voting on the action, although the law of corporate governance requires to validate the corporate action only disclosure of such a conflict of interest, following which the director may participate.\textsuperscript{23} If the board is closely divided on a matter of serious consequence to the corporation, however, the lawyer-director’s recusal as a director could interfere with the corporation’s selection of the best course to follow. In such a case, the lawyer-director may decide to withdraw her firm from consideration as counsel in the matter and participate fully in the board’s decision-making process. We emphasize that, in our opinion, no violation of any Model Rule would result if the lawyer participates in corporate action as a result of which she or her firm is employed to perform legal services.

D. Conflicts in Representing the Corporation in Litigation

Ethical issues also may arise when the corporation, its directors and its officers find themselves all named as defendants in litigation and they desire to be defended by their long-standing law firm, the one whose partner sits on the board of directors.

First, the corporation and its directors obviously need independent representation in any controversy between the corporation and its lawyers, \textit{see} Model Rule 1.7(a). The same ordinarily is true when representation of the corporation is required regarding a lawsuit involving the directors, one of whom is a lawyer in the corporation’s law firm, if the corporation may assert a cross claim against the lawyer-director or a third party claim against her law firm.\textsuperscript{24} Separate representation also would be required if the claims were derivative or there existed other potential conflicts between the corporation and its directors.\textsuperscript{25}

Second, indirectly conflicting interests involving Model Rule 1.7(b) also may generate a need for independent representation. If independent representation is required under Rule 1.7(b), the law firm whose member is a defendant cannot represent the corporation, at least without independent co-counsel also serving.\textsuperscript{26}

Third, prior representation of the corporation may prevent the firm from representing its own member under Model Rules 1.9(a) and 1.10(a), even if Rule 1.7(b) does not. Finally, as a general proposition, it is often awkward for a firm to represent one of the firm lawyers. Indeed, some professional liability carriers insist that law firms hire different counsel to represent them.\textsuperscript{27}

\textsuperscript{23} See Albert, \textit{supra} note 2, at 443.
\textsuperscript{24} See, \textit{e.g.}, Harrison v. Keystone Coca-Cola Bottling Co., 428 F. Supp. 149 (M.D. Pa. 1977) (lawyer-director’s firm must not represent corporation in litigation if the lawyer also is a defendant).
\textsuperscript{26} Model Rule 3.7 (Lawyer as Witness) also may preclude the lawyer-director’s firm from representing the corporation in litigation as a result of the existence of a conflict of interest under Rule 1.7 or 1.9 when the lawyer-director is to be a necessary witness. \textit{See} Comment [5].
\textsuperscript{27} Other types of representation of a corporation by a lawyer-director or her firm have the potential for conflicts of interest to arise. This is particularly true when the representation involves regulatory agencies in connection with public securities offer-
Summary

The Committee acknowledges that lawyers will continue to be asked and many will accept engagements as directors of client business entities and that it is not unethical for them to do so. It nevertheless is essential that lawyer-directors and their clients continue to be sensitive to the issues discussed in this opinion.

Though a lawyer serving in the dual role of corporate counsel and director is not subject to discipline absent a violation of a specific Rule, the following suggestions, derived from the foregoing discussion, should help to avoid a disciplinary infraction. The lawyer-director should:

1. Reasonably assure that management and the board of directors understand (i) the different responsibilities of legal counsel and director; (ii) that when acting as legal counsel, the lawyer represents only the corporate entity and not its individual officers and directors; and (iii) that at times conflicts of interest may arise under the rules governing lawyers’ conduct that may cause the lawyer to recuse herself as a director or to recommend engaging other independent counsel to represent the corporation in the matter, or to serve as co-counsel with the lawyer or her firm.

2. Reasonably assure that management and the board of directors understand that, depending upon the applicable law, the attorney-client evidentiary privilege may not extend to matters discussed at board meetings when the lawyer-director is not acting in her corporate counsel role and when other lawyers representing the corporation are not present in order to provide legal advice on the matters.

3. Recuse herself as a director from board and committee deliberations when the relationship of the corporation with the lawyer or her firm is under consideration, such as issues of engagement, performance, payment or discharge.

4. Maintain in practice the independent professional judgment required of a competent lawyer, recommending against a course of action that is illegal or likely to harm the corporation even when favored by management or other directors.

5. Perform diligently the duties of counsel once a decision is made by the board or management, even if, as a director, the lawyer disagrees with the decision, unless the representation would assist in fraudulent or criminal conduct, self-dealing or otherwise would violate the Model Rules.

6. Decline any representation as counsel when the lawyer’s interest as a director conflicts with her responsibilities of competent and diligent representation, for example, when the lawyer is so concerned over her personal liability as a director resulting from the course approved by management or the board that her representation of the corporation in the matter would be materially and adversely affected.

SO YOU WANNA JOIN A NONPROFIT BOARD?
The Bar Association of San Francisco
Presented by Erin Bradrick & Moderated by Victoria Weatherford

Selected Sections of the California Corporations Code

§ 5047.5 - (a) The Legislature finds and declares that the services of directors and officers of nonprofit corporations 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 corporations 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 corporation subject to Part 2 (commencing with Section 5110), Part 3 (commencing with Section 7110), or Part 4 (commencing with Section 9110) of this division 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 corporation; 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 corporations organized to provide religious, charitable, literary, 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 corporation maintains a liability insurance policy with an amount of coverage of at least the following amounts:
   (1) If the corporation'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 corporation'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 claim against the director or officer can also be made directly against the corporation and a liability insurance policy is applicable to the claim. If that
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.

(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 corporation 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 corporation that unlawfully restricts membership, services, or benefits conferred on the basis of political affiliation, age, or any characteristic listed or defined in subdivision (b) or (e) of Section 51 of the Civil Code.

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

§ 5111 - Subject to any other provisions of law of this state applying to the particular class of corporation or line of activity, a corporation may be formed under this part for any public or charitable purposes.

§ 5210 - Each corporation shall have a board of directors. Subject to the provisions of this part and any limitations in the articles or bylaws relating to action required to be approved by the members (Section 5034), or by a majority of all members (Section 5033), the activities and affairs of a corporation shall be conducted and all corporate powers shall be exercised by or under the direction of the board. The board may delegate the management of the activities of the corporation to any person or persons, management company, or committee however composed, provided that the activities and affairs of the corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the board.

§ 5213 – (a) A corporation shall have (1) a chair of the board, who may be given the title chair, chairperson, chairman, chairwoman, chair of the board, chairperson of the board, chairman of the board, or chairwoman of the board, or a president or both, (2) a secretary, (3) a treasurer or a chief financial officer or both, and (4) any other officers with any titles and duties as shall be stated in the bylaws or determined by the board and as may be necessary to enable it to sign instruments. The president, or if there is no president the chair of the board, is the general manager and chief executive officer of the corporation, unless otherwise provided in the articles or bylaws. Unless otherwise specified in the articles or the bylaws, if there is no chief financial officer, the treasurer is the chief financial officer of the corporation. Any number of offices may be held by the same person unless the articles or bylaws provide otherwise, except that no person serving as the secretary, the treasurer, or the chief financial officer may serve concurrently as the president or chair of the board. Any compensation of the president or chief executive officer and the chief financial officer or treasurer shall be determined in accordance with subdivision (g) of Section 12586 of the Government Code, if applicable.

(b) Except as otherwise provided by the articles or bylaws, officers shall be chosen by the board and serve at the pleasure of the board, subject to the rights, if any, of an officer under any contract of employment. Any officer may resign at any time upon written notice to the corporation without prejudice to the rights, if any, of the corporation under any contract to which the officer is a party.
(c) If the articles or bylaws provide for the election of any officers by the members, the term of office of the elected officer shall be one year unless the articles or bylaws provide for a different term which shall not exceed three years.

§ 5231 - (a) A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner that director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.

(b) In performing the duties of a director, a director shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, in each case prepared or presented by:
   (1) One or more officers or employees of the corporation whom the director believes to be reliable and competent in the matters presented;
   (2) Counsel, independent accountants or other persons as to matters which the director believes to be within that person's professional or expert competence; or
   (3) A committee upon which the director does not serve that is composed exclusively of any or any combination of directors, persons described in paragraph (1), or persons described in paragraph (2), as to matters within the committee’s designated authority, which committee the director believes to merit confidence, so long as, in any case, the director acts in good faith, after reasonable inquiry when the need therefor is indicated by the circumstances and without knowledge that would cause that reliance to be unwarranted.

(c) Except as provided in Section 5233, a person who performs the duties of a director in accordance with subdivisions (a) and (b) shall have no liability based upon any alleged failure to discharge the person's obligations as a director, including, without limiting the generality of the foregoing, any actions or omissions which exceed or defeat a public or charitable purpose to which a corporation, or assets held by it, are dedicated.

§ 5233 - (a) Except as provided in subdivision (b), for the purpose of this section, a self-dealing transaction means a transaction to which the corporation is a party and in which one or more of its directors has a material financial interest and which does not meet the requirements of paragraph (1), (2), or (3) of subdivision (d). Such a director is an “interested director” for the purpose of this section.

(b) The provisions of this section do not apply to any of the following:
   (1) An action of the board fixing the compensation of a director as a director or officer of the corporation.
   (2) A transaction which is part of a public or charitable program of the corporation if it (i) is approved or authorized by the corporation in good faith and without unjustified favoritism; and (ii) results in a benefit to one or more directors or their families because they are in the class of persons intended to be benefited by the public or charitable program.
   (3) A transaction, of which the interested director or directors have no actual knowledge, and which does not exceed the lesser of 1 percent of the gross receipts of the corporation for the preceding fiscal year or one hundred thousand dollars ($100,000).

(c) The Attorney General or, if the Attorney General is joined as an indispensable party, any of the following may bring an action in the superior court of the proper county for the remedies specified in subdivision (h):
(1) The corporation, or a member asserting the right in the name of the corporation pursuant to Section 5710.
(2) A director of the corporation.
(3) An officer of the corporation.
(4) Any person granted relator status by the Attorney General.

(d) In any action brought under subdivision (c) the remedies specified in subdivision (h) shall not be granted if:

(1) The Attorney General, or the court in an action in which the Attorney General is an indispensable party, has approved the transaction before or after it was consummated; or

(2) The following facts are established:
   (A) The corporation entered into the transaction for its own benefit;
   (B) The transaction was fair and reasonable as to the corporation at the time the corporation entered into the transaction;
   (C) Prior to consummating the transaction or any part thereof the board authorized or approved the transaction in good faith by a vote of a majority of the directors then in office without counting the vote of the interested director or directors, and with knowledge of the material facts concerning the transaction and the director’s interest in the transaction. Except as provided in paragraph (3) of this subdivision, action by a committee of the board shall not satisfy this paragraph; and
   (D) (i) Prior to authorizing or approving the transaction the board considered and in good faith determined after reasonable investigation under the circumstances that the corporation could not have obtained a more advantageous arrangement with reasonable effort under the circumstances or (ii) the corporation in fact could not have obtained a more advantageous arrangement with reasonable effort under the circumstances; or

(3) The following facts are established:
   (A) A committee or person authorized by the board approved the transaction in a manner consistent with the standards set forth in paragraph (2) of this subdivision;
   (B) It was not reasonably practicable to obtain approval of the board prior to entering into the transaction; and
   (C) The board, after determining in good faith that the conditions of subparagraphs (A) and (B) of this paragraph were satisfied, ratified the transaction at its next meeting by a vote of the majority of the directors then in office without counting the vote of the interested director or directors.

(e) Except as provided in subdivision (f), an action under subdivision (c) must be filed within two years after written notice setting forth the material facts of the transaction and the director’s interest in the transaction is filed with the Attorney General in accordance with such regulations, if any, as the Attorney General may adopt or, if no such notice is filed, within three years after the transaction occurred, except for the Attorney General, who shall have 10 years after the transaction occurred within which to file an action.

(f) In any action for breach of an obligation of the corporation owed to an interested director, where the obligation arises from a self-dealing transaction which has not been approved as provided in subdivision (d), the court may, by way of offset only, make any order authorized by subdivision (h), notwithstanding the expiration of the applicable period specified in subdivision (e).
(g) Interested directors may be counted in determining the presence of a quorum at a meeting of
the board which authorizes, approves or ratifies a contract or transaction.

(h) If a self-dealing transaction has taken place, the interested director or directors shall do such
things and pay such damages as in the discretion of the court will provide an equitable and fair
remedy to the corporation, taking into account any benefit received by the corporation and
whether the interested director or directors acted in good faith and with intent to further the best
interest of the corporation. Without limiting the generality of the foregoing, the court may order the
director to do any or all of the following:
   1. Account for any profits made from such transaction, and pay them to the corporation;
   2. Pay the corporation the value of the use of any of its property used in such transaction;
   and
   3. Return or replace any property lost to the corporation as a result of such transaction,
      together with any income or appreciation lost to the corporation by reason of such
      transaction, or account for any proceeds of sale of such property, and pay the proceeds to
      the corporation together with interest at the legal rate. The court may award prejudgment
      interest to the extent allowed in Section 3287 or 3288 of the Civil Code. In addition, the
court may, in its discretion, grant exemplary damages for a fraudulent or malicious violation
of this section.

§ 5237 - (a) Subject to the provisions of Section 5231, directors of a corporation who approve any
of the following corporate actions shall be jointly and severally liable to the corporation for:
   1. The making of any distribution.
   2. The distribution of assets after institution of dissolution proceedings of the corporation,
      without paying or adequately providing for all known liabilities of the corporation,
excluding any claims not filed by creditors within the time limit set by the court in a notice
given to creditors under Chapters 15 (commencing with Section 6510), 16 (commencing
with Section 6610) and 17 (commencing with Section 6710).
   3. The making of any loan or guaranty contrary to Section 5236.

(b) A director who is present at a meeting of the board, or any committee thereof, at which action
specified in subdivision (a) is taken and who abstains from voting shall be considered to have
approved the action.

(c) Suit may be brought in the name of the corporation to enforce the liability:
   1. Under paragraph (1) of subdivision (a) against any or all directors liable by the persons
      entitled to sue under subdivision (b) of Section 5420;
   2. Under paragraph (2) or (3) of subdivision (a) against any or all directors liable by any
      one or more creditors of the corporation whose debts or claims arose prior to the time of
      the corporate action who have not consented to the corporate action, whether or not they
      have reduced their claims to judgment;
   3. Under paragraph (1), (2) or (3) of subdivision (a), by the Attorney General.

(d) The damages recoverable from a director under this section shall be the amount of the illegal
distribution, or if the illegal distribution consists of property, the fair market value of that property
at the time of the illegal distribution, plus interest thereon from the date of the distribution at the
legal rate on judgments until paid, together with all reasonably incurred costs of appraisal or other
valuation, if any, of that property, or the loss suffered by the corporation as a result of the illegal
loan or guaranty.
(e) Any director sued under this section may implead all other directors liable and may compel contribution, either in that action or in an independent action against directors not joined in that action.

(f) Directors liable under this section shall also be entitled to be subrogated to the rights of the corporation:

(1) With respect to paragraph (1) of subdivision (a), against the persons who received the distribution.

(2) With respect to paragraph (2) of subdivision (a), against the persons who received the distribution.

(3) With respect to paragraph (3) of subdivision (a), against the person who received the loan or guaranty.

Any director sued under this section may file a cross-complaint against the person or persons who are liable to the director as a result of the subrogation provided for in this subdivision or may proceed against them in an independent action.

§ 5238 - (a) For the purposes of this section, “agent” means any person who is or was a director, officer, employee or other agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another foreign or domestic corporation, partnership, joint venture, trust or other enterprise, or was a director, officer, employee or agent of a foreign or domestic corporation that was a predecessor corporation of the corporation or of another enterprise at the request of the predecessor corporation; “proceeding” means any threatened, pending or completed action or proceeding, whether civil, criminal, administrative or investigative; and “expenses” includes without limitation attorneys’ fees and any expenses of establishing a right to indemnification under subdivision (d) or paragraph (3) of subdivision (e).

(b) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any proceeding (other than an action by or in the right of the corporation to procure a judgment in its favor, an action brought under Section 5233, or an action brought by the Attorney General or a person granted relator status by the Attorney General for any breach of duty relating to assets held in charitable trust) by reason of the fact that the person is or was an agent of the corporation, against expenses, judgments, fines, settlements and other amounts actually and reasonably incurred in connection with the proceeding if the person acted in good faith and in a manner the person reasonably believed to be in the best interests of the corporation and, in the case of a criminal proceeding, had no reasonable cause to believe the conduct of the person was unlawful. The termination of any proceeding by judgment, order, settlement, conviction or upon a plea of nolo contendere or its equivalent shall not, of itself, create a presumption that the person did not act in good faith and in a manner which the person reasonably believed to be in the best interests of the corporation or that the person had reasonable cause to believe that the person’s conduct was unlawful.

(c) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action by or in the right of the corporation, or brought under Section 5233, or brought by the Attorney General or a person granted relator status by the Attorney General for breach of duty relating to assets held in charitable trust, to procure a judgment in its favor by reason of the fact that the person is or was an agent of the corporation, against expenses actually and reasonably incurred by the person in connection with the defense or settlement of the action if the person acted in good faith, in a manner the person believed to be in the best interests of the corporation and with such care,
including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances. No indemnification shall be made under this subdivision:

(1) In respect of any claim, issue or matter as to which the person shall have been adjudged to be liable to the corporation in the performance of the person's duty to the corporation, unless and only to the extent that the court in which the proceeding is or was pending shall determine upon application that, in view of all the circumstances of the case, the person is fairly and reasonably entitled to indemnity for the expenses which the court shall determine;

(2) Of amounts paid in settling or otherwise disposing of a threatened or pending action, with or without court approval; or

(3) Of expenses incurred in defending a threatened or pending action which is settled or otherwise disposed of without court approval unless it is settled with the approval of the Attorney General.

(d) To the extent that an agent of a corporation has been successful on the merits in defense of any proceeding referred to in subdivision (b) or (c) or in defense of any claim, issue or matter therein, the agent shall be indemnified against expenses actually and reasonably incurred by the agent in connection therewith.

(e) Except as provided in subdivision (d), any indemnification under this section shall be made by the corporation only if authorized in the specific case, upon a determination that indemnification of the agent is proper in the circumstances because the agent has met the applicable standard of conduct set forth in subdivision (b) or (c), by:

(1) A majority vote of a quorum consisting of directors who are not parties to the proceeding;

(2) Approval of the members (Section 5034), with the persons to be indemnified not being entitled to vote thereon; or

(3) The court in which the proceeding is or was pending upon application made by the corporation or the agent or the attorney or other person rendering services in connection with the defense, whether or not the application by the agent, attorney, or other person is opposed by the corporation.

(f) Expenses incurred in defending any proceeding may be advanced by the corporation prior to the final disposition of the proceeding upon receipt of an undertaking by or on behalf of the agent to repay the amount unless it shall be determined ultimately that the agent is entitled to be indemnified as authorized in this section. The provisions of subdivision (a) of Section 5236 do not apply to advances made pursuant to this subdivision.

(g) No provision made by a corporation to indemnify its or its subsidiary's directors or officers for the defense of any proceeding, whether contained in the articles, bylaws, a resolution of members or directors, an agreement or otherwise, shall be valid unless consistent with this section. Nothing contained in this section shall affect any right to indemnification to which persons other than the directors and officers may be entitled by contract or otherwise.

(h) No indemnification or advance shall be made under this section, except as provided in subdivision (d) or paragraph (3) of subdivision (e), in any circumstance where it appears:

(1) That it would be inconsistent with a provision of the articles, bylaws, a resolution of the members or an agreement in effect at the time of the accrual of the alleged cause of action asserted in the proceeding in which the expenses were incurred or other amounts were paid, which prohibits or otherwise limits indemnification; or
(2) That it would be inconsistent with any condition expressly imposed by a court in approving a settlement.

(i) A corporation shall have power to purchase and maintain insurance on behalf of any agent of the corporation against any liability asserted against or incurred by the agent in such capacity or arising out of the agent's status as such whether or not the corporation would have the power to indemnify the agent against that liability under the provisions of this section; provided, however, that a corporation shall have no power to purchase and maintain that insurance to indemnify any agent of the corporation for a violation of Section 5233.

(j) This section does not apply to any proceeding against any trustee, investment manager, or other fiduciary of a pension, deferred compensation, saving, thrift, or other retirement, incentive, or benefit plan, trust, or provision for any or all of the corporation's directors, officers, employees, and persons providing services to the corporation or any of its subsidiary or related or affiliated corporations, in that person's capacity as such, even though the person may also be an agent as defined in subdivision (a) of the employer corporation. A corporation shall have power to indemnify the trustee, investment manager or other fiduciary to the extent permitted by subdivision (f) of Section 5140.

§ 5239 - (a) There shall be no personal liability to a third party for monetary damages on the part of a volunteer director or volunteer executive officer of a nonprofit corporation subject to this part, caused by the director's or officer's negligent act or omission in the performance of that person's duties as a director or officer, if all of the following conditions are met:

1. The act or omission was within the scope of the director's or executive officer's duties.
2. The act or omission was performed in good faith.
3. The act or omission was not reckless, wanton, intentional, or grossly negligent.
4. Damages caused by the act or omission are covered pursuant to a liability insurance policy issued to the corporation, either in the form of a general liability policy or a director's and officer's liability policy, or personally to the director or executive officer. In the event that the damages are not covered by a liability insurance policy, the volunteer director or volunteer executive officer shall not be personally liable for the damages if the board of directors of the corporation and the person had made all reasonable efforts in good faith to obtain available liability insurance.

(b) "Volunteer" means the rendering of services without compensation. "Compensation" means remuneration whether by way of salary, fee, or other consideration for services rendered. However, the payment of per diem, mileage, or other reimbursement expenses to a director or executive officer does not affect that person's status as a volunteer within the meaning of this section.

(c) "Executive officer" means the president, vice president, secretary, or treasurer of a corporation, or such other individual who serves in like capacity, who assists in establishing the policy of the corporation.

(d) Nothing in this section shall limit the liability of the corporation for any damages caused by acts or omissions of the volunteer director or volunteer executive officer.

(e) This section does not eliminate or limit the liability of a director or officer for any of the following:

1. As provided in Section 5233 or 5237.
2. In any action or proceeding brought by the Attorney General.
(f) Nothing in this section creates a duty of care or basis of liability for damage or injury caused by the acts or omissions of a director or officer.

(g) This section is only applicable to causes of action based upon acts or omissions occurring on or after January 1, 1988.

(h) As used in this section as applied to nonprofit public benefit corporations which have an annual budget of less than twenty-five thousand dollars ($25,000) and that are exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code, the condition of making “all reasonable efforts in good faith to obtain available liability insurance” shall be satisfied by the corporation if it makes at least one inquiry per year to purchase a general liability insurance policy and that insurance was not available at a cost of less than 5 percent of the previous year's annual budget of the corporation. If the corporation is in its first year of operation, this subdivision shall apply for as long as the budget of the corporation does not exceed twenty-five thousand dollars ($25,000) in its first year of operation.

An inquiry pursuant to this subdivision shall obtain premium costs for a general liability policy with an amount of coverage of at least five hundred thousand dollars ($500,000).

**Selected Sections of the Internal Revenue Code**

§ 501 - (a) **EXEMPTION FROM TAXATION.** An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

(b) **TAX ON UNRELATED BUSINESS INCOME AND CERTAIN OTHER ACTIVITIES.** An organization exempt from taxation under subsection (a) shall be subject to tax to the extent provided in parts II, III, and VI of this subchapter, but (notwithstanding parts II, III, and VI of this subchapter) shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

(c) **LIST OF EXEMPT ORGANIZATIONS.** The following organizations are referred to in subsection (a): ...

   (3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

...

§ 4958 - (a) **INITIAL TAXES.**

(1) **ON THE DISQUALIFIED PERSON.** There is hereby imposed on each excess benefit transaction a tax equal to 25 percent of the excess benefit. The tax imposed by this
paragraph shall be paid by any disqualified person referred to in subsection (f)(1) with respect to such transaction.

(2) ON THE MANAGEMENT. In any case in which a tax is imposed by paragraph (1), there is hereby imposed on the participation of any organization manager in the excess benefit transaction, knowing that it is such a transaction, a tax equal to 10 percent of the excess benefit, unless such participation is not willful and is due to reasonable cause. The tax imposed by this paragraph shall be paid by any organization manager who participated in the excess benefit transaction.

(b) ADDITIONAL TAX ON THE DISQUALIFIED PERSON. In any case in which an initial tax is imposed by subsection (a)(1) on an excess benefit transaction and the excess benefit involved in such transaction is not corrected within the taxable period, there is hereby imposed a tax equal to 200 percent of the excess benefit involved. The tax imposed by this subsection shall be paid by any disqualified person referred to in subsection (f)(1) with respect to such transaction.

(c) EXCESS BENEFIT TRANSACTION; EXCESS BENEFIT. For purposes of this section—

(1) EXCESS BENEFIT TRANSACTION.

(A) In general. The term “excess benefit transaction” means any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit. For purposes of the preceding sentence, an economic benefit shall not be treated as consideration for the performance of services unless such organization clearly indicated its intent to so treat such benefit.

(B) Excess benefit. The term “excess benefit” means the excess referred to in subparagraph (A).

(2) SPECIAL RULES FOR DONOR ADVISED FUNDS. In the case of any donor advised fund (as defined in section 4966(d)(2))—

(A) the term “excess benefit transaction” includes any grant, loan, compensation, or other similar payment from such fund to a person described in subsection (f)(7) with respect to such fund, and

(B) the term “excess benefit” includes, with respect to any transaction described in subparagraph (A), the amount of any such grant, loan, compensation, or other similar payment.

(3) SPECIAL RULES FOR SUPPORTING ORGANIZATIONS.

(A) In general. In the case of any organization described in section 509(a)(3)—

(i) the term “excess benefit transaction” includes—

(I) any grant, loan, compensation, or other similar payment provided by such organization to a person described in subparagraph (B), and

(II) any loan provided by such organization to a disqualified person (other than an organization described in subparagraph (C)(ii)), and

(ii) the term “excess benefit” includes, with respect to any transaction described in clause (i), the amount of any such grant, loan, compensation, or other similar payment.

(B) Person described. A person is described in this subparagraph if such person is—

(i) a substantial contributor to such organization,
(ii) a member of the family (determined under section 4958(f)(4)) of an individual described in clause (i), or
(iii) a 35-percent controlled entity (as defined in section 4958(f)(3) by substituting “persons described in clause (i) or (ii) of section 4958(c)(3)(B)” for “persons described in subparagraph (A) or (B) of paragraph (1)” in subparagraph (A)(i) thereof).

(C) Substantial contributor. For purposes of this paragraph—

(i) In general. The term “substantial contributor” means any person who contributed or bequeathed an aggregate amount of more than $5,000 to the organization, if such amount is more than 2 percent of the total contributions and bequests received by the organization before the close of the taxable year of the organization in which the contribution or bequest is received by the organization from such person. In the case of a trust, such term also means the creator of the trust. Rules similar to the rules of subparagraphs (B) and (C) of section 507(d)(2) shall apply for purposes of this subparagraph.

(ii) Exception. Such term shall not include—

(I) any organization described in paragraph (1), (2), or (4) of section 509(a), and

(II) any organization which is treated as described in such paragraph (2) by reason of the last sentence of section 509(a) and which is a supported organization (as defined in section 509(f)(3)) of the organization to which subparagraph (A) applies.

(4) Authority to include certain other private inurement. To the extent provided in regulations prescribed by the Secretary, the term “excess benefit transaction” includes any transaction in which the amount of any economic benefit provided to or for the use of a disqualified person is determined in whole or in part by the revenues of 1 or more activities of the organization but only if such transaction results in inurement not permitted under paragraph (3) or (4) of section 501(c), as the case may be. In the case of any such transaction, the excess benefit shall be the amount of the inurement not so permitted.

(d) Special rules. For purposes of this section—

(1) Joint and several liability. If more than 1 person is liable for any tax imposed by subsection (a) or subsection (b), all such persons shall be jointly and severally liable for such tax.

(2) Limit for management. With respect to any 1 excess benefit transaction, the maximum amount of the tax imposed by subsection (a)(2) shall not exceed $20,000.

(e) Applicable tax-exempt organization. For purposes of this subchapter, the term “applicable tax-exempt organization” means—

(1) any organization which (without regard to any excess benefit) would be described in paragraph (3), (4), or (29) of section 501(c) and exempt from tax under section 501(a), and

(2) any organization which was described in paragraph (1) at any time during the 5-year period ending on the date of the transaction.

Such term shall not include a private foundation (as defined in section 509(a)).

(f) Other definitions. For purposes of this section—

(1) Disqualified person. The term “disqualified person” means, with respect to any transaction—
(A) any person who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization,
(B) a member of the family of an individual described in subparagraph (A),
(C) a 35-percent controlled entity,
(D) any person who is described in subparagraph (A), (B), or (C) with respect to an organization described in section 509(a)(3) and organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of the applicable tax-exempt organization,[1]
(E) which involves a donor advised fund (as defined in section 4966(d)(2)), any person who is described in paragraph (7) with respect to such donor advised fund (as so defined), and
(F) which involves a sponsoring organization (as defined in section 4966(d)(1)), any person who is described in paragraph (8) with respect to such sponsoring organization (as so defined).

(2) ORGANIZATION MANAGER. The term “organization manager” means, with respect to any applicable tax-exempt organization, any officer, director, or trustee of such organization (or any individual having powers or responsibilities similar to those of officers, directors, or trustees of the organization).

(3) 35-PERCENT CONTROLLED ENTITY.

(A) In general. The term “35-percent controlled entity” means—
(i) a corporation in which persons described in subparagraph (A) or (B) of paragraph (1) own more than 35 percent of the total combined voting power,
(ii) a partnership in which such persons own more than 35 percent of the profits interest, and
(iii) a trust or estate in which such persons own more than 35 percent of the beneficial interest.

(B) Constructive ownership rules. Rules similar to the rules of paragraphs (3) and (4) of section 4946(a) shall apply for purposes of this paragraph.

(4) FAMILY MEMBERS. The members of an individual's family shall be determined under section 4946(d); except that such members also shall include the brothers and sisters (whether by the whole or half blood) of the individual and their spouses.

(5) TAXABLE PERIOD. The term “taxable period” means, with respect to any excess benefit transaction, the period beginning with the date on which the transaction occurs and ending on the earliest of—
(A) the date of mailing a notice of deficiency under section 6212 with respect to the tax imposed by subsection (a)(1), or
(B) the date on which the tax imposed by subsection (a)(1) is assessed.

(6) CORRECTION. The terms “correction” and “correct” mean, with respect to any excess benefit transaction, undoing the excess benefit to the extent possible, and taking any additional measures necessary to place the organization in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards, except that in the case of any correction of an excess benefit transaction described in subsection (c)(2), no amount repaid in a manner prescribed by the Secretary may be held in any donor advised fund.

(7) DONORS AND DONOR ADVISORS. For purposes of paragraph (1)(E), a person is described in this paragraph if such person—
(A) is described in section 4966(d)(2)(A)(iii),
(B) is a member of the family of an individual described in subparagraph (A), or
(C) is a 35-percent controlled entity (as defined in paragraph (3) by substituting “persons described in subparagraph (A) or (B) of paragraph (7)” for “persons described in subparagraph (A) or (B) of paragraph (1)” in subparagraph (A)(i) thereof).

(8) INVESTMENT ADVISORS. For purposes of paragraph (1)(F)—

(A) In general. A person is described in this paragraph if such person—

(i) is an investment advisor,

(ii) is a member of the family of an individual described in clause (i), or

(iii) is a 35-percent controlled entity (as defined in paragraph (3) by substituting “persons described in clause (i) or (ii) of paragraph (8)(A)” for “persons described in subparagraph (A) or (B) of paragraph (1)” in subparagraph (A)(i) thereof).

(B) Investment advisor defined. For purposes of subparagraph (A), the term “investment advisor” means, with respect to any sponsoring organization (as defined in section 4966(d)(1)), any person (other than an employee of such organization) compensated by such organization for managing the investment of, or providing investment advice with respect to, assets maintained in donor advised funds (as defined in section 4966(d)(2)) owned by such organization.
So You Wanna Join a Nonprofit Board?

THE BAR ASSOCIATION OF SAN FRANCISCO

Presented by Erin Bradrick &
Moderated by Victoria Weatherford
Agenda

• Nonprofit & 501(c)(3) basics
• Role of the Board of Directors
• Directors’ Fiduciary Duties
• What to Know About the Nonprofit
• Conflicts of Interest
• Director Liability
• The Lawyer on the Board
• Summary and Questions
• Supplemental Materials
Nonprofit & 501(c)(3) Basics
Terminology

“Nonprofit”

- State corporate law
- No owners/no distribution to owners

“Tax-Exempt”

- Federal & state tax law
- Exempt from corporate income tax on certain income
Types of Nonprofit Legal Entities

• **Unincorporated Nonprofit Associations**

• **Nonprofit Corporations**
  - **Public benefit (Cal. Corp. Code §§ 5110-6910)**
    • May be formed for any public or charitable purposes
  - **Mutual benefit (Cal. Corp. Code §§ 7110-8910)**
    • May be formed for any lawful purpose
    • May be formed primarily or exclusively for any religious purposes

• **Trust**
Exempt Organizations – § 501(c)(3)

501(c)(3) - Entity organized and operated exclusively for one or more of the following purposes:

- Religious
- Charitable
- Scientific
- Testing for public safety
- Literary
- Educational
- Foster national or international sports competition
- Prevention of cruelty to children or animals
Organizational Test:

- Organized *exclusively* for one or more exempt purposes as set forth in its governing documents

Operational Test:

- Organization must be operated *primarily* for one or more exempt purposes
- Only “insubstantial part” of organization’s activities may be devoted to non-exempt purposes
Role of the Board of Directors
The Board’s Powers & Responsibilities

- To **Direct** the course of the corporation
  - Its effectiveness and efficiency at furthering its mission
  - Its compliance with applicable legal requirements
- To **Oversee** the corporation’s activities and performance
- To **Protect** the public interest
Role of Directors & Officers

• Individual Directors have no inherent authority
  • The collective Board of Directors has ultimate authority
  • Cal. Corp. Code § 5210 – “the activities and affairs of the corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the board”

• Individual officers have the authority granted by the Board
  • While officers generally serve at the pleasure of the Board, they are often authorized to act with broad discretion
Directors’ Fiduciary Duties
A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner that director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under the circumstances.

- Cal. Corp. Code § 5231(a)
Fiduciary Duties

- Duty of Care
- Duty of Loyalty
- Duty of Obedience
Duty of Care - Standards

Must act with the care:

• An ordinarily prudent person
• In like position
• Would use under similar circumstances
Duty of Care - Requirements

• Be informed
  • Attend meetings
  • Obtain adequate information and ask questions
  • Review materials before meetings

• Act in good faith and with due care
  • Exercise independent judgment
  • Make informed decisions
May rely on information, opinions, reports, and statements from certain people (Cal. Corp. Code § 5231):

1. Officers and employees
2. Experts (including counsel and accountants)
3. Board committees
4. Other committees of directors + 1 and/or 2

– in good faith and with due care

CANNOT RELY ON BLIND FAITH
Duty of Care – Delegation

May delegate management of activities to (Cal. Corp. Code § 5210):

- Officers
- Committees
- Volunteers
- Staff

BUT must be under ultimate authority and direction of the Board

**CANNOT DELEGATE OVERSIGHT**
Duty of Loyalty – Requirements

• Undivided allegiance to corporation

• No misappropriation of a corporate opportunity

• Disclosure of possible conflicts of interest

• Abstention from voting where possible conflict of interest exists

• Maintaining confidentiality where appropriate
Duty of Loyalty – Corporate Opportunity

If you become aware of opportunity and ...

• Should know
  - offer is to corporation
  - activity is of interest to corporation

• Know
  - it is in line with corporation’s business
  - it is of practical advantage to corporation
  - that corporation can financially undertake it

Then → Offer it to the corporation first
Duty of Obedience

- Carry out the corporation’s purpose
- Comply with the law
- Refrain from *ultra vires* (beyond the corporation’s powers) activities
What to Know
About the Nonprofit
Where to Start

Get familiarized with the organization’s:

- Mission
- Activities (including fundraising)
- Legal and organizational structure
- Governing documents
- Governance structures, policies and procedures
- Management structure
- Financial picture
Conflicts of Interest
Conflicts of Interest

COI = interest in proposed transaction to which the corporation may be a party

Dealing with conflict of interest:

- Disclosure to Board: interest + material facts
- Transaction was fair & reasonable to corporation at the time
- Approval by majority of disinterested Board members
Self-Dealing Transactions

Apply to any transaction to which the organization is a party and in which one or more of its Directors has a material financial interest (Cal. Corp. Code § 5233)

No penalty for self-dealing if:

- For the benefit of the organization
- Fair and reasonable to the organization at the time
- Board has knowledge of the Director’s interest
- Disinterested Directors approve the transaction in advance
- Prior to approval, Board considers alternatives
Rebuttable Presumption of Reasonableness

- Approval in advance by disinterested board (or committee)
- Appropriate comparability data
- Concurrent documentation
  - Shifts burden to IRS to prove the payment was unreasonable
Director Liability
Director Liability Exposure

- Breach of fiduciary duties
- Self-dealing
- Excess benefit transactions
- Actions outside scope of authority
- Employment claims
- Failure to withhold payroll taxes
- Failure to observe corporate formalities
- Other claims (e.g., torts, contracts, defamation)
Protections

• Satisfying obligations & duties

• Indemnification
  • Permissible, prohibited, and mandatory

• Directors and Officers (D&O) liability insurance

• Other insurance (e.g., general commercial liability)
Statutory Protections

State statutory protection, including...

- Business judgment rule (Cal. Corp. Code § 5231(c))
  - “a person who performs the duties of a director in accordance with [fiduciary duties]) shall have no liability based upon any alleged failure to discharge the person’s obligations as a director, including, without limiting the generality of the foregoing, any actions or omissions which exceed or defeat a public or charitable purpose to which a corporation, or assets held by it, are dedicated”
- Director involved in a potential self-dealing situation will not be liable if the Board follows the procedures set forth in Cal. Corp. Code § 5233
- Limited monetary liability for volunteers (Cal. Corp. Code §§ 5047.5, 5239)
The Lawyer on the Board
Potential Issues

Role Confusion

- Director
- Counsel (engagement agreement, ethics rules, subject matter competence)

Conflicts of Interest

- Nonprofit & Law Firm (or client of firm)

Heightened Exposure

- Reliance defense of fellow directors
More Potential Issues

Loss of Attorney-Client Privilege

• Is nonprofit the client?
• Business advice incidental to legal advice

Heightened Standard of Care?

• For a Director providing legal counsel

Insurance

• D&O may not cover legal advice
• Professional Liability coverage?
Summary Recommendations

• Understand Board expectations for your role

• Obtain written approval and conflict check/screen from your firm/company, before serving on Board

• Have Board chair provide written confirmation you are/are not serving as legal counsel for nonprofit and will/will not provide legal advice

• Confirm your insurance coverage (D&O and malpractice)

• Recuse yourself from all conflicted discussions and decisions at Board
Questions

Erin Bradrick
Senior Counsel
NEO Law Group
Erin@NEOLawGroup.com
415.977.0558
Supplemental Materials
What to Know About the Nonprofit
Articles of Incorporation

• Type of Corporation

• Purpose Clause
  • Broad or narrow?
  • Does it fully encompass your mission?
  • Do your activities further your stated purpose?

• Dedication & Dissolution Clauses
  (for public benefit and religious corporations)
Bylaws

• Purpose Statement
• Directors
  • Number: Fixed or Range
  • Restriction on Interested Directors
  • Election
  • Removal
• Board Meetings
  • Annual, Regular, Special
  • Notice
  • Quorum
  • Voting (not by e-mail)
Bylaws Continued

• Committees
  • Board Committees
  • Audit Committee (Nonprofit Integrity Act)
  • Other Committees

• Officers
  • Requires: President and/or Chair, Secretary & Treasurer
  • Election
  • Duties
  • Terms

• Indemnification
Membership Organizations

• Selection Criteria
• Types
• Termination & Terms
• Meetings
  • Annual, regular, special
  • Notice
  • Quorum
  • Voting (Proxy voting permitted as default)
  • Election of Directors
Laws to Know

- California Laws
  - Corporate Laws
  - Tax Laws
  - Charitable Trust Doctrine
- Federal Tax Exemption Laws
- Charitable Solicitation Laws
  - California
  - Other Jurisdictions
- Prudent Investment Laws
Charitable Trust Doctrine

- Organization holds assets in trust for use in furtherance of exempt purposes
- Must honor any restrictions placed on contributions
- Purposes at time of contribution are a restriction on its use
  - Purposes evidenced in Articles of Incorporation, Bylaws, and in other oral or written statements and representations to the public
  - If organization’s stated purposes change over time, contributions previously received still must be used for purposes at time of receipt
Conflicts of Interest
No Private Inurement

• Net earnings cannot inure to the benefit of an “insider”

  • “Insiders” – founders, Directors, and Officers, and other persons in a position to influence decisions of the organization

Penalty = loss of exempt status
No Prohibited Private Benefit

Organization must serve public, rather than private, interests

May benefit individuals if incidental to furthering organization’s exempt purposes

- Members of a class served by organization
- May pay for necessary services
No Excess Benefit Transactions

RULE: Organization cannot directly or indirectly confer an economic benefit on a disqualified person that exceeds the value of what the organization received in return

• “Disqualified Person” = substantial influencer, current or former Director, CEO, CFO, relatives, 35% entities
No Excess Benefit Transactions

Penalty: Intermediate Sanctions

- Disqualified person - 25%, 200% tax
- Board, if knowing and willing approval - 10% tax (up to $20,000)
The information contained in this presentation has been prepared by NEO Law Group and is not intended to constitute legal advice. NEO Law Group has used reasonable efforts in collecting, preparing, and providing this information, but does not guarantee its accuracy, completeness, adequacy, or currency. The publication and distribution of this presentation are not intended to create, and receipt does not constitute, an attorney-client relationship.