LAWYERS’ SERVICE ON NONPROFIT BOARDS:
FIDUCIARY DUTIES, BEST PRACTICES, AND ETHICAL ISSUES

Presented by the
Nonprofit Organizations Committee

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Program Chair:  
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Lawyers’ Service on Nonprofit Boards: Fiduciary Duties, Best Practices, and Ethical Issues

INCLUDED MATERIALS

I. Lawyers’ Service on Nonprofit Boards: Fiduciary Duties, Best Practices, and Ethical Issues – Abstract (Lisa A. Runquist)

II. Lawyers’ Service on Nonprofit Boards: Fiduciary Duties, Best Practices, and Ethical Issues – Outline (Lisa A. Runquist and Willard L. Boyd III)

III. Lawyers’ Service on Nonprofit Boards: Managing the Risks of an Important Community Activity – Article (Willard L. Boyd III)

IV. Biographies
ABA Business Law Section
Annual Meeting
September 12-14, 2019
Lawyers’ Service on Nonprofit Boards:
Fiduciary Duties, Best Practices, and Ethical Issues
Lisa A. Runquist
Lisa A. Runquist, Attorney at Law
Materials Summary
Abstract
With many nonprofit organizations, there has been a tendency to select members of the board of directors on the basis of the prestige these directors will lend to the organization. Many directors respond by regarding the position as an “honorary” or “figurehead” type of position, rather than actively participating in the direction and oversight of the organization.

Also, a number of nonprofits have boards that are self-perpetuating, and thereby seem to become a law unto themselves. Directors serving on this type of a board may fall into the trap of thinking that they can do whatever they desire with the corporation even if such activities are not in the best interests of the organization. This is often true when the founder retains power and considers the organization his or her own.

Neither view is correct. Director must actively oversee the operation of the organization. By law, they are subject to certain fiduciary obligations. Depending on state law, the standard of care applied may be the “prudent person” standard, or it may be the higher fiduciary standards applicable to the trustee of a trust.

This analysis examines the questions that should be asked by directors in determining the scope of their responsibilities and how these responsibilities should be fulfilled. Although other questions may be relevant in specific situations, directors who follow the approach outlined below should be well on the way to fulfilling their legal commitments to the organization. The following questions should be asked:

**WHAT ARE THE STATED PURPOSES OF THE ORGANIZATION?**
A nonprofit organization must use all of its assets to advance the purposes for which the organization was formed, as set out in its articles of incorporation and/or bylaws (stated purposes). These stated purposes are controlling over all other statements of policy issued by the organization.
Assets may be used both for direct and indirect expenses. If feeding the poor is a stated purpose, the cost of the food and its distribution are direct expenses, and the cost of administration of the program and solicitation of funds are indirect expenses. All of these costs are justified. However, expenses to fulfill another purpose not included in the stated purposes of the organization are not justified, even if this other purpose is more commendable.

Directors should, on taking office, review the organizational documents (articles, bylaws, constitution) to become fully aware of the stated purposes. All decisions of the board should be made, and all corporate policies developed, in light of those stated purposes.

**DOES THE TRANSACTION ADVANCE THE STATED PURPOSES?**
Directors should review each major transaction to test whether it advances, either directly or indirectly, the stated purposes. If there is any doubt, the board should postpone the transaction until there is a consensus as to how the transaction advances the corporate purposes. The minutes of the board meeting at which the matter is considered should reflect this rationale.

**DOES THE TRANSACTION BENEFIT A PRIVATE INDIVIDUAL?**
Nonprofit organizations having a public or charitable benefit, including religious organizations, are normally exempt from taxation under IRC § 501(c)(3). This section prohibits organization assets from being used primarily to benefit an individual. An organization can pay employees adequate salaries and benefits without violating this provision. And an activity that benefits the organization is permitted even if an individual receives a benefit. However, the board should determine what the benefit is to the organization before an activity may be implemented, and the minutes should reflect the benefits of the activity. If the board determines that the primary benefit is to an individual, then the activity should not be implemented.

If this requirement is violated and private benefit is found, the organization’s tax-exempt status may be lost. In fact, a finding of private inurement has been the basis for denying tax-exempt status to “mail order” churches.

In addition to possible loss of exempt status of the organization, under the intermediate sanctions rules effective September 14, 1995, if a person who was in a position to exercise substantial influence over the organization anytime in the past five years receives an “excess benefit”, that person must make the organization whole (e.g. return the excess benefit, plus interest) and is subject to a substantial penalty (ranging from 25% to 200% of the excess benefit). Further, anyone approving the excess benefit (e.g. the directors) are subject to a penalty of 10% of the excess benefit, up to $10,000 per transaction.

In reviewing any transaction, a director must make sure that the activity does not result in “private benefit.”

**WERE ANY PROMISES MADE WHEN THE FUNDS WERE RAISED?**
Funds raised for a specific purpose must be used for that specific purpose and no other. Generally, the organization should either return the funds to the donor, or obtain a waiver of the original purpose from the donor or a court order directing disposition before the funds are used for another purpose. State law may affect the steps necessary to change the use of the funds.
An organization should generally qualify even special appeals to allow funds raised to be used at the discretion of the board. If representations are made when the funds are raised, the director must see that those funds are used in the manner represented.

**WERE ANY CONDITIONS PLACED ON THE DONATED FUNDS?**
Assets may be given to an organization conditioned on those assets being used for a specific purpose. The organization may either accept the assets for that purpose, if it is consistent with the organization’s stated purposes, or refuse to accept the assets subject to the condition. The organization may not accept the assets and use them for a purpose other than the purpose specified by the donor.

**DOES THE DIRECTOR ATTEND THE MEETINGS?**
One duty of a director is the duty of reasonable care.

“Regular attendance at meetings of the board of directors is a basic element of prudent performance as a director.” Page 22, Guidebook for Directors of Nonprofit Corporations, American Bar Association (1993).

To fulfill their responsibilities, directors must provide direction for the operations of the organization. State laws generally allow for proxies for members but not for directors. If directors are unable to regularly attend the meetings of the board, they will be unable to provide the necessary guidance to the corporation. Further, the directors will remain responsible for actions taken by the board, even in their absence.

Before agreeing to become a director, individuals should consider the necessary time commitment. If they are unable to make the commitment, the position should be declined. A director who later becomes unable to attend board meetings regularly would be well advised to resign.

**ARE MEETINGS HELD REGULARLY?**
Although directors are not normally responsible for calling meetings, a director should request that meetings be held as often as necessary to cover the business of the organization. Meetings should be held at least annually. Many organizations have regular board meetings quarterly, bi-monthly, or monthly.

Most states provide that officers or two or more directors can call a board meeting.

**DOES THE DIRECTOR HAVE ALL THE RELEVANT FACTS?**
To make an informed decision about an action, a director must have all the relevant facts. For instance, if the organization proposes to construct a new building, the board should review any zoning issues, building permits, cost of construction (with bids), proposed financing arrangements, and similar factors before approving or disapproving the plan. The board also should review any legal consequences of its decision and examine any alternatives (such as buying an existing building) that would be more beneficial to the organization.

A director should insist on having all of the appropriate information to review and should review the information before making a decision.
“To function effectively, a director needs to have an adequate source of information flow. This information is generally supplied by the staff. To the extent that it is not adequate, a board or an individual director will have to determine what additional information is needed. Needless to say, the director should read the information with which he or she is supplied.” ibid, at Page 22.

If for any reason sufficient information is not made appropriately available, the director should request that action be delayed until the information is made available.

IS THERE ANY REASON NOT TO TRUST THE INFORMATION BEING FURNISHED?
Directors are responsible for the overall activities of the organization, but generally do not manage the organization on a day-to-day basis. Consequently, they normally do not directly gather the information about the proposed activities. Unless there is some reason to suspect the reliability or competence of the individual furnishing the information, the directors may rely on the information furnished. However, directors must make whatever additional inquiries are necessary to satisfy themselves as to the validity of the information furnished if there is reasonable doubt of its reliability.

ARE TAXES BEING PAID?
If the organization has employees, income taxes and, in most cases, social security taxes must be withheld and paid. If they are not withheld, the organization may still be liable for the amounts that should have been withheld. The organization, any responsible individuals, and often the directors themselves will be found to be personally liable for the amounts due even when the directors did not know these payments were not being made. This is especially true if the director had signatory authority on the bank accounts.

IS THERE A CONFLICT OF INTEREST OR SELF DEALING?
Each director has a duty of complete loyalty. Directors may not use the position of director for personal profit, or to gain a personal advantage. A director cannot personally take advantage of an opportunity that belongs to the organization; nor can directors use the organization to better themselves. For instance, if the organization is looking for a piece of land and the director finds a suitable parcel for a good price, the director cannot buy the parcel and then sell it to the organization for a higher price. If the director already owns a suitable parcel of land, he or she cannot sell it to the organization for more than its value to the organization. And, if the director owns a parcel of land that is unsuitable, he or she should not attempt to sell it to the organization.

It is preferable to avoid entirely any activity that involves self-dealing (that is, any activity between the person as an individual and the person as a director/trustee). If self-dealing is unavoidable or is clearly of benefit to the organization, most states will allow it. However, the director should make sure that the conflict of interest is disclosed, that it does not result in an unjustified advantage to the interested director, and that it is beneficial to the organization. Even if this is done, some states will allow the transaction to be voided at the option of the organization, regardless of the results.

Corporate loans to either directors or officers are one type of self-dealing that is of particular concern. Directors who vote in favor of these loans may be liable for them in the event that the loan is unauthorized or otherwise impermissible. Boards must check the state law under which they are incorporated before considering these loans.
The director should make sure that state law permits the self-dealing transaction. If it does, the director should make sure that the conflict of interest is totally disclosed and that the activity is beneficial to the organization itself. [Note: See also INTERMEDIATE SANCTIONS – New Regulations.]

The directors should also make sure that a conflict of interest policy is adopted by the organization, and that all directors, officers and employees are aware of and agree to abide by the policy.

**IS THE TRANSACTION FAIR TO THE ORGANIZATION?**
A director should determine whether an activity is fair and reasonable as far as the organization is concerned. This is normally a judgment call; however, if self-dealing is involved (see above), then the transaction must actually be fair and reasonable.

**HOW WOULD AN ORDINARILY REASONABLE AND PRUDENT PERSON DECIDE THE MATTER?**
Corporate directors are expected to choose the course of action that an ordinarily reasonable and prudent person would choose in the same or similar circumstances. However, with a nonprofit corporation, that standard may differ from the standard applied in a business setting when viewed in the light of the purposes and ideals of the organization.

Therefore, the decision should not be made on the basis of what an ordinarily reasonable and prudent person in a business setting would decide, but what an ordinarily reasonable and prudent person would decide in light of these purposes and ideals. With a religious organization, the religious beliefs and doctrine must also be taken into account.

**ARE THERE OTHER LAWS THAT AFFECT THE PARTICULAR SITUATION?**
There are laws that might affect both the liability of the corporation and the directors’ liability in a particular area. For instance, the organization and its directors are not exempt from the securities laws, or from criminal laws regarding fraudulent activities. And some nonprofits have found that the anti-trust laws apply to them. This type of information should be part of the information provided when a particular activity is considered by the board.

**HOW ACCURATE ARE THE RECORDS?**
Another duty of a director is the duty to account. To do this, the records of an organization must be accurate. There should be sufficient internal accounting and management procedures to assure the accuracy and control of the organization’s activities and funds. As part of the recordkeeping, there should be no commingling of funds among directors’ assets, the organization’s assets, and the assets belonging to any other individual or organization. Assets should be held in the name of the organization or in the name of an individual in trust for the organization or for a specified purpose.

“… [T]he records and accounting of the trustees should constitute a complete and a clear, accurate and distinct report and disclosure in detail of the administration of the trust, showing receipts and their sources, payments by him, and the balance remaining, to the end of distributing to the beneficiary the trust property or funds or their value, with income thereon and increments thereto, and without profits to the trustee, although allowing him compensation and reimbursement.” 76 Am. Jur. 2d, Section 507.
IS THE DIRECTOR ACTING HONESTLY, IN GOOD FAITH, AND WITH TOTAL INTEGRITY?
The duty to act in good faith requires directors to perform their duties honestly and with integrity. This duty incorporates a number of duties already discussed. For instance, directors cannot rely on information they know to be false or engage in self-dealing without violating this duty.

IS THIS TRANSACTION IN THE BEST INTERESTS OF THE ORGANIZATION?
Once a director has reviewed all of the issues relevant to the transaction, found the transaction to be consistent with the purposes of the organization, and reviewed all the information concerning the matter, then the director should take the opportunity to look at the entire picture. At this time, the director should make a determination that this activity or transaction is in the best interests of the organization and that there is no better alternative available at the present time.

If directors ask all of the questions listed above and acts in accordance with the suggestions, it is likely that the directors will be performing their duties satisfactorily. However, things can still go wrong, even with the most well-intentioned director and organization. The second step is to document the fact that the decisions of the directors were made after due consideration of the various factors. The greatest liability and exposure occurs, not when a wrong decision was made after due consideration, but when no decision was made at all or was made without due consideration. If proper documentation is made beforehand (for example, in the minutes of the board meetings), a court is unlikely to second-guess the decision of the board.

One basic practical difference between a profit and a nonprofit corporation in the area of directors’ liability boils down to this: If the board of a for-profit corporation is sued and wins on the question of liability, the primary cost is the cost of defense. If the board of a nonprofit corporation is sued, even if it wins on the question of liability, it loses the cost of defense and, more importantly, it may lose credibility with its donors. This loss of credibility may be difficult or impossible to repair. A recognition of this danger and a strategic plan to avoid the neutralization of the charity by careful attention to the above issues will limit the risk that a legal test would ever be contemplated.
Lawyers’ Service on Nonprofit Boards: Fiduciary Duties, Best Practices, and Ethical Issues

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Overview of Presentation

• Introduction
• Fiduciary Duties of Directors
• Best Practices
• Ethical Considerations
  – Existence of Lawyer/Client Relationship
  – Competency
  – Confidentiality
  – Conflicts of Interest
• Additional Issues Arising for Lawyer/Directors
• Protections Available for the Lawyer/Director
• General Considerations for Lawyer/Director
Lawyers’ Service on Nonprofit Boards - Introduction

- Generally recognized that a lawyer’s service on a non-client nonprofit board presents substantially less risk than a lawyer serving on a client’s board
- Still, many lawyers on nonprofit boards find themselves performing free legal services even if they do not intend to make nonprofit a client
- In addition, some lawyers represent nonprofits as part of their pro bono service. Model Rule 6.1

- Directors of nonprofit corporations are held to two primary duties:
  1. Duty of Care
  2. Duty of Loyalty
- Applies to all Directors, even if appointed by or as a representative of another group (e.g. regional affiliate, medical staff, church, parent corporation)
- Bring perspective, but maintain fiduciary obligation to organization for which serve as Director
- Clarify overlapping duties/potential conflicts with other organization that is source of appointment
Duty of Care

- The Duty of Care requires Directors to act:
  - In good faith, and
  - With the care that a person in a like position would reasonable believe appropriate in like circumstances
- Special hazards for lawyers and other experts serving on boards
  - Separate legal/other expertise from board role, if possible
  - But cannot leave expertise “at the door” when reviewing organization activities

Duty of Care (continued)

- The Duty of Care recognizes that as members of the Board and committees of the Board, Directors have both a decision-making function and an oversight function
- Ask Questions
- Insider’s tip: Be respectful – but not to the point of ignoring your responsibilities
Duty of Care (continued)

- The decision-making function relates to the a specific decision or action of the Board as a whole
- Major decision items should generally not come as a surprise to the board
- Prior information, discussion; committee review
- The oversight function relates to the general activity of the Board overseeing delegated management of operations

Duty of Care (continued)

- In carrying out the Duty of Care, a Director is able to reasonably rely on others for information, including:
  - One or more officers of the organization
  - The organization’s legal counsel and accountants
  - Other persons as to matters involving skills or expertise the director reasonably believes are:
    - matters within the particular person’s professional or expert competence; or
    - matters as to which the particular person merits confidence
Duty of Care (continued)

- Director’s **Reasonable** Reliance on Others (cont’d):
  - A committee of the board
  - For churches and other religious organizations, religious authorities (including ministers, priests, rabbis), with respect to matters within such authority’s purview – for example, Catholic Church canon law requirements

Duty of Care (continued)

- **Limits:** Director may not rely on an individual/group’s opinion if the Director knows information that makes the reliance unwarranted
  - Expert hazard: Directors with special expertise
    - Example: Lawyer/Director is an expert in tax law and identifies a problem with tax advice being provided by outside counsel
Duty of Loyalty

• The Duty of Loyalty requires that the Director
  — Act in good faith; and
  — In a manner the director reasonably believes to be
    in the best interests of the organization
• Duty of loyalty requires that the Director place the
  interests of the nonprofit before the Director’s
  private interests
  — “Obedience” to organization’s mission/purposes
  — Director’s personal interest may be deemed to
    include interests of other organizations with which
    the Director volunteers, or is employed be aware of
    potential conflicts

Duty of Loyalty (continued)

• The Duty of Loyalty can arise in different
  situations:
  — Conflict of Interest Transactions
  — Taking of Opportunity Desirable for Organization
    • Real estate
    • Other assets
    • Potential transactions
    • Especially if become aware of because of Director
      status
    • Generally, no duty to offer to organization if
      learned of opportunity in professional/personal
      capacity – but consider appearances, reaction
Duty of Loyalty (continued)

- Use of Director status for personal gain
  - Reputational enhancement OK
  - Solicitation/acceptance of gifts from current/potential vendors can be questionable
- Failure to disclose, or to be transparent prevents other Directors, counsel from determining how to address conflict

Duty of Loyalty (continued)

- A conflict of interest transaction is a transaction with the organization in which a Director, her company or family member has a direct or indirect financial (or other) interest in a transaction that is subject to the board’s approval
- **Example:** a Director is asked to vote on engagement of a law firm in which the Director is a partner – or of which the Director’s daughter-in-law is a partner
  - Less concern if other company a large, well-known concern, especially in “ordinary course” transactions; but disclosure always best practice
Duty of Loyalty (continued)

- Conflict of interests do occur, are not necessarily problematic
- An organization may benefit from a conflict of interest transaction if it is able to procure good quality goods or services at a favorable price as a result of a Director’s “connection”; however, care should be taken to demonstrate compliance with conflicts policy at both initial contracting stage and during ongoing relationship
- Key to conflict of interest transactions: managed by a standard process that is transparent and helps prevent the organization from being harmed
- Also, avoids appearance of impropriety, fodder for organization critics

Importance of Conflict of Interest Policy
- Annual written (may be electronic) disclosures by all directors of actual or potential conflicts
- Disclosure of particular conflicts when arise
- May ask for connections with listed major vendors
- Encourage broad interpretation – adult child employed by national consulting firm used by organization; personal relationship with CEO of potential merger partner
- Require director recusal, non-participation in Board deliberations
- Protects both organization and director from criticism, challenge
Duty of Loyalty (continued)

- State laws often provide that a transaction in which a Director of an organization has a conflict of interest may be voidable if:
  - the material facts of the transaction and the Director’s interest were not disclosed or known to the board or a committee of the board; and/or
  - The transaction was not fair to the organization
- Board or board committee authorization, approval, or ratified after disclosures and consideration of conflict typically sufficient to negate voidability result

Duty of Loyalty (continued)

- Record Conflict Management Steps Taken: Important to document in meeting minutes how a conflict transaction was addressed (for significant matters, may have counsel prepare or review draft minutes)
  - Minutes should reflect the Director’s disclosure of the conflict as well as the vote by the board that indicates the director did not vote, and whether or not the director was present at or participated in the discussion
Duty of Loyalty (continued)

• An annual written conflict disclosure in which a director identifies entities in which the director or immediate family member has a financial interest (or serves as an executive) will help the organization identify potential conflict of interest situations
• Also helps avoid the appearance of impropriety as a result of business relationships involving a director or a member of the director’s family in which the connection to a director may not be obvious

Duty of Loyalty (continued)

• Intermediate Sanctions
  – CEO, COO, CFO and other executive officers/employers compensation must be set by the board or board committee composed of disinterested members
  – Determination of board needs to be based on objective facts
  – Determination of board needs to be in minutes
Best Practices

• Learn about the nonprofit organization
  – Its services
  – Its sources of funding and financial condition
• Learn about the expectations for directors
  – How long are the terms?
  – Is a lawyer/board member expected to provide legal services to the organization?

Best Practices (continued)

• Regularly attend all Board and committee meetings and be prepared and ready to engage in discussion.
• Regularly review financial statements of organization
  – Insist that they be provided prior to each meeting
• During discussions, make sure you share your perspective
• If you have any questions or concerns with regard to a matter being discussed by the Board or the organization in general, make sure you are expressing such questions or concerns to the appropriate persons in the organization
Best Practices (continued)

• Recognize that directors provide oversight and not implementation:
  – Focus on the big picture issues and strategic direction of the organization as opposed to the day-to-day operations of the organization
  – Let the CEO do his/her job
  – Evaluation of CEO may include discussion with those the CEO oversees

Ethical Considerations for the Lawyer/Director

• Various ethical issues can arise in the situation where a lawyer is both a director and the lawyer for the nonprofit
Establishment of Lawyer-Client Relationship

- Lawyer-Client relationship may be established through various requests by the board or management of the nonprofit
- Examples:
  - Review of Bylaws
  - Review of Executive Director’s employment agreement
  - Preparation of application for tax-exempt status

Establishment of Lawyer-Client Relationship (continued)

- Lawyers are required to comply with the state rules of professional conduct in establishing lawyer-client relationships
- Even if lawyer/director is providing legal services on pro bono basis, lawyer-client relationship is established
  - Lawyer can be subject to professional liability for services provided on pro bono basis
**Competency**

- **Model Rule 1.1 – Competence**
  - A lawyer shall provide competent representation to a client
  - Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation
- Duty can arise in situations where lawyer on board is asked to provide advice regarding matter
- Important to recognize that fact lawyer may be providing “pro bono” representation does not eliminate need to comply with Rule 1.1

**Competency (continued)**

- **Considerations:**
  - Is lawyer/director qualified to provide legal services?
  - What will be the scope of the services?
  - Important to establish expectations of what lawyer/director will do with respect to nonprofit
Confidentiality

• Model Rule 1.6 – Confidentiality
  – A lawyer may not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is otherwise permitted by Rule 1.6
  – Rule 1.6 permits disclosure for purposes of:
    • Preventing death or bodily harm
    • Preventing or mitigating injury to financial interests of third party resulting from fraud or criminal activity
    • Defend against claim against lawyer or seek advice relating to representation
    • Court order

Confidentiality (continued)

• Considerations:
  – Lawyer/Director has confidentiality duties under both the duty of loyalty and state rules of professional conduct
  – Need to be mindful that even in situations where it is permissible under the duty of care to disclose information, it may not be permissible under the state rules of professional conduct
Conflict of Interest

• Model Rule 1.7: Conflict of Interest: Current Clients
  – General Rule: A lawyer shall not represent client if representation involves concurrent conflict of interest

Conflict of Interest (continued)

• Concurrent conflict of interest exists if:
  – Representation of one client will be directly adverse to another client; or
  – Significant risk that representation of one or more clients will be materially limited by lawyer’s responsibilities to another client, former client, or third person or by personal interest of the lawyer.
• Potential Conflicts of Interest Situations:
  — Lawyer serving on board of nonprofit that is adverse to client of the lawyer’s law firm
  — Lawyer serving on board of nonprofit that makes contributions to a client of lawyer’s law firm

Conflict of Interest (continued)

— Lawyer/Director who provides legal services to nonprofit relating to:
  • Pursuing client objectives that the lawyer, as director, opposed
  • Opining on board actions in which the lawyer-director participated
  • Corporate actions affecting the lawyer’s law firm
  • Representation of the corporation in litigation
  • ABA Formal Opinion 98-410
Conflict of Interest (continued)

- Lawyer for nonprofit corporation or other organization who is also member of its board should determine whether responsibilities of two roles may conflict

Conflict of Interest (continued)

- Consideration should be given to:
  - Frequencies of situations in which lawyer may be called on to advise corporation on matters involving directors’ actions;
  - Potential intensity of such conflict;
  - Effect of the lawyer/director’s resignation from board; and
  - Possibility of organization obtaining separate legal counsel
Conflict of Interest (continued)

• If material risk that dual role will compromise lawyer’s independence, lawyer should not serve as director or should cease to act as nonprofit corporation’s lawyer when conflicts arise

Conflict of Interest (continued)

• Lawyers should advise other members of the board that in some circumstances matters discussed by the board will not be protected by the attorney-client privilege and conflict of interest considerations may require the lawyer’s recusal as director or might require lawyer and lawyer’s law firm to decline representation of corporation
Lawyers’ Board Service – Additional Issues

• Lawyer/Director might be held to higher fiduciary standards:
  – Cases in securities law context hold lawyer/directors to higher standards than other directors
    • Unclear whether higher standards will be imposed on nonprofit lawyer/director
  – Director/Lawyer who serves as lawyer for nonprofit expected to have more extensive knowledge of the organization

Lawyers’ Board Service – Additional Issues

(continued)

• Vicarious Firm Liability for Lawyer/Director Service on Nonprofit Boards
  – Risk that when a lawyer/director is found to breach a fiduciary duty, the lawyer’s law firm can be held vicariously liable
  – Theory: Lawyer’s service was authorized by, or was on behalf of, law firm
Lawyers’ Board Service – Additional Issues  
(continued)

• Attorney-Client Privilege Risks
  – Legal advice, and not business advice, protected by attorney-client privilege
  – Lawyer/Director’s dual role can make it difficult to insure that communication is protected by attorney-client privilege
  – Important that board members be aware of what hat lawyer/director is wearing when communicating with board members
    • ABA Formal Opinion 98-410 states that lawyer must warn corporate client of possible loss of attorney-client privilege

Lawyers’ Board Service – Additional Issues  
(continued)

• IRS Intermediate Sanctions
  – Lawyers serving on boards of tax-exempt clients should be concerned about private inurement and excess benefit prohibitions that can lead to imposition of penalty excise taxes on Directors receiving excess benefits
Protections for Lawyer/Directors

• Professional liability coverage
  – Generally does not cover claims arising out of lawyer’s service on board
  – Some policies will cover pro bono representation of nonprofit corporation as long as lawyer is not receiving fee (not paid to firm)

Protections for Lawyer/Directors (continued)

• Many state laws provide liability protection for volunteer (unpaid or minimally compensated) directors and officers
• The Federal Volunteer Protection Act provides for civil liability protection for nonprofit volunteers (with comp. up to $500)
• Does not protect against being sued
• Shield/immunity applies if Director/officer acting within scope of his/her responsibilities
• Not protected: actions reflecting high level of misconduct, e.g., deliberate intention to harm, gross negligence, reckless misconduct, utter indifference/conscious disregard for safety of others
Protections for Lawyer/Directors (continued)

• State laws typically allow a nonprofit corporation to indemnify its directors, as well as others acting on behalf of the organization
• Check language of Articles of Incorporation, Bylaws, statute – assure maximum protection
• Advancement of expenses – best practice: provide for repayment commitment if later determined to be ineligible
  – e.g., found to have breached Duty of Loyalty, or did not satisfy required standard of conduct

Protections for Lawyer/Director (continued)

• A third type of protection for Directors is directors and officers ("D&O") liability coverage
• D&O coverage can cover judgments against Directors and officers as well as legal fees incurred by them in defending themselves in a lawsuit brought against them in their capacity as Directors and officers of a nonprofit
• D&O coverage also covers the organization, but may have different deductible
• May not cover lawyer on the board, or lawyer/officer, if deemed to be acting in a lawyer capacity; other experts may also be at risk
• Ask for summary or copy of policy: good practice to assure periodic review with insurance broker, coverage counsel
Considerations on Becoming a Director

- Obtain information regarding nonprofit regarding:
  - Expectations of Directors
  - Expectations of lawyer/directors
  - Indemnification and D&O coverage
  - Lawyer’s professional liability coverage
- Treat organization as “client” of law firm for purposes of conflict checks

Considerations on Becoming a Director (continued)

- Discuss with board parameters of lawyer/director’s legal services to organization
- Discuss with board how conflict of interest situations will be handled by the board
- When speaking in role as lawyer to organization, make such role known to the board
  - Such recognition should help protect attorney-client privilege
Considerations on Becoming a Director

(continued)

– An ABA Business Law Section report states that subject to the cautions described above, assuming that a lawyer makes the necessary commitment of time and effort, the lawyer and nonprofit corporation should in many instances be able to conclude that the lawyer’s service on the board would be in the best interests of the nonprofit corporation

• 57 Bus. Law 387 (November 2001)

CONCLUSION
Lawyers' Service on Nonprofit Boards
Managing the Risks of an Important Community Activity

By Willard L. Boyd III

At some point in your career, a local charity, church, or other nonprofit will ask you to serve on its board. This can be an important way to become more involved in your community. Since most nonprofits have limited resources, they may expect a lawyer/director to provide some form of legal services on a pro bono basis. As a result, although many lawyers join boards with different intentions, they often provide some type of legal services to nonprofits.

A lawyer/director must be mindful of the fiduciary duties imposed on directors of nonprofit organizations, the ethical duties imposed on lawyers, as well as the potential issues that arise as a result of a lawyer serving on a nonprofit board. Although there are some risks associated with such service, there are ways that these risks might be managed.

Overview of Duties
Directors of nonprofit organizations generally have two main fiduciary duties: the duty of care and duty of loyalty. The duty of care requires the director to act with the care a person in a like position would reasonably believe to be appropriate under similar circumstances. The duty of loyalty requires the director to act in good faith and in a manner that the director reasonably believes to be in the best interests of the organization. The duty of loyalty also covers conflict of interest situations. The Model Nonprofit Corporation Act (3d ed.), Revised Model Nonprofit Corporation Act, and many states' nonprofit statutes provide a process for handling conflict of interest situations, which generally requires, at a minimum, the disclosure of a potential conflict and the nonparticipation of the conflicted director in the action taken by the organization with regard to the conflict situation.

In terms of the ethical obligations imposed on lawyers in their representation of clients, Rule 1.7 of the American Bar Association Model Rules of Professional Conduct (Model Rules) provides that a lawyer may not represent a client if such representation involves a concurrent conflict of interest. Some key concepts with this particular rule are the duty of loyalty a lawyer has to the client and the need for the lawyer to be able to exercise independent judgment.

Potential Conflicts of Interest
Conflicts can arise for lawyers serving as members of a nonprofit's board of directors because of the duties imposed on nonprofit directors as well as lawyers' ethical duties to clients as set forth in the Model Rules. As part of the duty of loyalty, a director is required to act in the best interests of the organization, which can include, for example, not using confidential information of the organization to the detriment of the organization. With such duty to the organization, a lawyer's service on the board of directors of a nonprofit might preclude the lawyer or the lawyer's law firm from being adverse to such organization. This was the situation in Berry v. Saline Mem'l Hosp., 907 S.W.2d 736 (Ark. 1995), when a hospital in Arkansas was sued by a party represented by a law firm in which one of the lawyers was a former trustee of the hospital. In that case, the Arkansas Supreme Court upheld a lower court's disqualification of the law firm on the basis that a lawyer in the firm was a former hospital trustee and, as such, had a fiduciary relationship with the hospital and continued to owe the hospital a duty of loyalty.

Conflicts also can arise for a lawyer/director when the lawyer's firm represents a client that is a grant recipient of the nonprofit. There is some opinion that such a situation may preclude a lawyer from serving on the nonprofit board. Still, to the extent the situations occur infrequently, the organization and lawyer/director should be able to handle them by following conflict of interest requirements that are imposed by state statute and the organization's conflict of interest policies.

Other types of conflicts can arise when the lawyer/director is serving as the lawyer for the nonprofit. There is no ethical prohibition against a lawyer
serving as a director of a client. Still, the dual role can give rise to potential conflicts. ABA Formal Ethics Opinion 98-410 identifies four possible conflict situations, and, although the focus of the formal ethics opinion is primarily on for-profit organizations, the rationale can apply to nonprofit organizations. The first situation is when the lawyer is asked to formulate the organization's tax advice. This could occur when an organization decides to pursue a lawsuit against a third party that the lawyer opposes. According to the formal ethics opinion, a lawyer needs to determine whether his or her representation of the organization may be materially limited by the lawyer/director's position as a director of the organization. The second situation occurs when a lawyer is asked to opine on board actions in which the lawyer participated. Here, there would be a conflict for the lawyer/director is unable to have the independence of professional judgment required for such representation. Still, as noted by the Committee on Lawyer Business Ethics of the Section of Business Law in its report, The Lawyer as Director of Client, 57 B. A. L. (Nov. 2001), the circumstances that require a lawyer to opine on the actions of the board should be infrequent, and in those situations it would be prudent, and even ethically required, that the organization be advised to seek the advice of other legal counsel.

The third situation described in the formal ethics opinion is when the board is taking action affecting the lawyer's law firm, such as when the board is determining whether to retain the law firm. In such a situation, it would be important to comply with the applicable conduct of interest procedures and make sure the lawyer/director is not part of the decision process. The fourth situation described in the formal ethics opinion is when the lawyer or lawyer's law firm represents the corporation in litigation that includes the organization and directors as defendants. Among other things, it notes the need for the organization and directors to have independent representation in any controversy between the organization and its lawyers (including the lawyer/director).

Comment 35 to Model Rule 1.7 states that “[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.” According to the comment, “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.” The comment also states that “[i]f there is material risk that the dual role will compromise the lawyer’s independence of professional judgment, the lawyer should not serve as a director or should cease to act as the corporation’s lawyer when conflicts of interest arise.”

Lawyer-Client Relationship

The provision of legal services to a nonprofit helps many lawyers fulfill their pro bono obligations. See Model Rule 6.1. When a lawyer/director provides legal services to the organization on a pro bono basis, it should be assumed that a lawyer-client relationship is formed and the duties of a lawyer to the client apply whether the lawyer receives compensation or serves pro bono.

As previously noted, many lawyers join nonprofit boards with the expectation of not serving as the lawyer for the organization. Still, they can end up providing legal services, such as would be the case when the lawyer works on amendments to the articles of incorporation or bylaws of the organization, prepares the executive director’s employment agreement, or assists with an application for tax-exempt status for the organization. In such situations, the lawyer can be deemed to have a lawyer-client relationship with the organization. The problem is that it often is unclear when the lawyer/director has crossed the line of being a director and starts providing legal services. For instance, the lawyer/director could be providing legal services in a board meeting when he or she makes comments of a legal nature with regard to the advisability of amending the bylaws of the organization. To reduce the risk of others viewing the lawyer/director as the lawyer for the organization, the lawyer/director needs to make clear to statements to other board members that the lawyer/director is not acting as a lawyer for the organization and, if appropriate, recommend that the organization seek legal advice from another lawyer or law firm.

Attorney-Client Privilege Waivers

Assuming there is a lawyer-client relationship, the lawyer/director's dual roles can, in some situations, make it difficult to ensure that the attorney-client privilege protects communications between the lawyer and the nonprofit organization. A basic element of the privilege is that the lawyer act as legal counsel rather than as a business advisor to protect communication from disclosure in litigation. In the for-profit context, communications from a lawyer/director that involve business issues (as opposed to legal advice) have been held not protected by the attorney-client privilege. The same argument could be made in the nonprofit context.

Although the lawyer/director should understand when he or she is acting as legal counsel as opposed to a business advisor, these separate roles may not be clear to non-lawyer directors and officers of the organization. These other directors and officers may believe that the lawyer/director's presence at the meeting protects their communications by the attorney-client privilege. The comments to Model Rule 1.7 provide that a lawyer needs to warn a corporate client of the potential loss of the attorney-client privilege when the lawyer is also a board member.

Other Issues

Commentators have noted that in the for-profit context, a lawyer/
director's dual role as a legal advisor and corporate manager makes it more likely that a lawyer/director will be a defendant in corporate litigation. The report of the Task Force on the Independent Lawyer of the ABA Section of Litigation states that a lawyer for an organization who is also a director is expected to have more extensive knowledge and conduct more extensive investigations into the facts than other outside directors, and, in general, is held to a higher standard of care than either a director who is not a lawyer or a lawyer for the organization who is not a director. Without significant case law in the lawyer/nonprofit director context, it is unclear whether the heightened standards of care for lawyers/directors developed in the for-profit context will apply to lawyers/directors who represent the nonprofits on whose boards they serve. Commentators also have noted that in the for-profit context, there is a risk that when a lawyer/director violates a fiduciary duty with regard to the entity, the lawyer's law firm can be held vicariously liable on the basis that it authorized the lawyer's service. It is unclear whether such a claim would succeed in the nonprofit context. To the extent that the lawyer/director's law firm does not represent the organization, the risk of such a claim should be significantly reduced.

**Many lawyers join nonprofit boards with the expectation of not serving as the lawyer for the organization.**

Protection for Lawyers

The protections available to directors of nonprofit organizations and lawyers are also available to lawyers/directors. In terms of protections for nonprofit directors, the Model Nonprofit Corporation Act (3d ed.), the Revised Model Nonprofit Corporation Act, and many states' nonprofit statutes provide a liability shield for directors and officers acting in such capacity. The Act (3d ed.) provides that a director of a charitable nonprofit shall not be held liable to the corporation or its members for money damages for any action taken or any failure to take any action, as a director, except liability for: (1) the amount of a financial benefit received by the director to which the director is not entitled; (2) an intentional infliction of harm; (3) an unlawful distribution; or (4) an intentional violation of criminal law.

The model acts and most state nonprofit statutes also allow a nonprofit to indemnify its directors and officers. The Model Nonprofit Corporation Act (3d ed.) allows a nonprofit corporation to mandate that the nonprofit will indemnify its directors to the same extent that they are protected under the liability shield. Although indemnification rights are important, such rights are helpful only to the extent that the organization has the financial resources to provide the indemnification.

Directors and officers (D&O) insurance coverage can be very helpful in protecting lawyers in their service as directors of a nonprofit organization. In addition, professional liability coverage should provide protection for the lawyer/director when acting in the role of the lawyer for the organization. Still, it is important to recognize that professional liability coverage generally does not cover claims arising out of a lawyer's service as a director, and D&O policies often limit claims arising solely out of service as a director or officer. Each carrier may have an argument that its coverage does not apply if, in a given fact situation, the role of the lawyer/director is unclear.

**Considerations for Lawyers**

Before agreeing to serve as a director or officer of a nonprofit organization, a lawyer should review:

- The expectations of the lawyer/director regarding legal representation. Does another law firm represent the organization? What type of legal services, if any, will the organization expect of the lawyer/director or the lawyer/director's law firm? Will the nonprofit organization expect the lawyer/director to provide it with regular legal services and, if so, is there a likelihood that conflicts will arise? (To the extent the lawyer will be regularly providing legal services and conflicts are likely to arise, the lawyer should consider not serving on the board.)
- The organization's governance documents and applicable state nonprofit law. What are the articles, bylaws, and applicable state nonprofit statute provide with regard to liability, immunity, indemnification, and conflicts of interest?
- The organization's D&O liability coverage. What are the amounts and limits of the coverage, and what types of acts does it cover?
- The lawyer's professional liability coverage. Will the coverage cover acts or services provided to a nonprofit organization? Are there any limitations in the coverage if the lawyer is also a director of the board?

The law firm's conflict database should process the involvement of a lawyer as a director of a nonprofit organization in order to identify and analyze potential conflict issues. This will help address on a prospective basis situations such as the Arkansas hospital case discussed earlier where a lawyer's former role as a trustee of a hospital precluded the law firm from being adverse to the hospital.

In accepting a position on the board of directors of a client organization, a lawyer/director should provide an explanation of the potential conflicts of interest and how they might preclude the lawyer/director from acting as.
either the director or a lawyer on some issues or require safeguards, such as engaging the services of counsel other than the lawyer/director or the lawyer/director’s law firm. Such an explanation can be provided through a letter to the organization’s executive director and chair of the board of directors, who should acknowledge the letter in writing. It is also important to make the other board members aware of the potential conflicts. The distribution of the letter to other board members and a discussion with them can accomplish this. The minutes should reflect the fact that the discussion took place. Moreover, as noted above, in order to address a potential conflict adequately, a lawyer/director should not participate in board or committee deliberations and actions on the relationship of the organization with the lawyer.

When a lawyer/director speaks to the board as a lawyer for the organization, he or she should communicate that fact and remind the board of the methods of preserving the lawyer-client privilege. If the minutes reflect the fact that the lawyer communicated his or her role as the lawyer for the organization, they strengthen the assertion of the existence of that privilege. The minutes need not (and should not) describe the substance of the legal advice.

If the lawyer/director agrees to take on a specific limited representation of the organization, such as preparing restated articles of incorporation or an employment agreement for the executive director, the lawyer should make clear—preferably in writing to the organization—the extent of the representation. Moreover, the lawyer may reduce the risk for a potential conflict problem by not participating in the board approval of any actions relating to the representation, such as voting on the restated articles of incorporation or the employment agreement.

Conclusion

Service on a nonprofit board can be very rewarding to both the lawyer/director and the organization. The Committee on Lawyer Business Ethics of the Section of Business Law concludes in its report, The Lawyer as Director of a 501(c)(3) Corporation, that, assuming the lawyer makes the necessary commitment of time and effort, a lawyer and nonprofit organization should in many cases be able to conclude that the risks of the lawyer’s service on the organization’s board are not unreasonable and that it is in the nonprofit organization’s best interest to have the lawyer join the board.
Lawyers’ Service on Nonprofit Boards: Fiduciary Duties, Best Practices, and Ethical Issues

BIOGRAPHIES

Willard L. Boyd III (Panelist)

Bill Boyd is a member of Nyemaster Goode’s Business, Finance, and Real Estate Department and practices in the area of corporate law (organization, operation, and planning), regulatory law (financial institutions, health, certificate of need, insurance, and government contracts), and commercial law (secured loans, contracting matters, mergers, and acquisitions). Mr. Boyd has extensive experience representing financial institutions, insurance companies, health care providers, and nonprofits, including foundations. Prior to joining Nyemaster Goode, Mr. Boyd practiced with a law firm in Washington, D.C.

Mr. Boyd is a frequent speaker on corporate governance, privacy, and business entity issues. He is a contributor to the Iowa Legal Research Guide, the Iowa State Bar Association Business Law Manual, and the Legal Guide for Iowa Nonprofits. He is a past Chair of the Business Law Section and Trade Regulation Section of the Iowa State Bar Association. Mr. Boyd is also active in the American Bar Association and serves as a liaison to the ABA Corporate Laws Committee. He is a past chair of the Nonprofit Organizations Committee and the State and Local Bar Relations Committee of the ABA Business Law Section.

Mr. Boyd received his B.A. with high honors from the University of Michigan and his J.D. with distinction from the University of Iowa College of Law.

Lisa A. Runquist (Panelist)

Lisa Runquist has practiced law with both nonprofit organizations and business organizations since her admission to the Minnesota Bar in 1977 and to the California Bar in 1978. Ms. Runquist is a graduate from Hamline University, where she received her B.A., with distinction, in Philosophy, and the University of Minnesota Law School.

Ms. Runquist is a prolific writer and author. She is the author of a guidebook, The ABCs of Nonprofits, first published in April 2005, with the 2nd edition published in 2015 by the American Bar Association, Business Law Section. (Click here to read a review by Stephen Nill, founder of CharityChannel.) The ABCs of Nonprofits has now been released in Spanish as well! Ms. Runquist is also the principal author and editor of the Guide to Representing Religious Organizations, published in February 2009 by the American Bar Association, Business Law Section. She writes and speaks on a regular basis, has contributed extensively to professional literature regarding nonprofit organizations, and is regarded as an expert in the area of nonprofit organization law. Ms. Runquist was the first recipient of the Outstanding Lawyer Award by the ABA Business Law Section, A Nonprofit Lawyers Award, and the first to receive both the Outstanding Lawyer Award AND the Vanguard Award.

Ms. Runquist has been AV Peer Review Rated by Martindale-Hubbell for over 25 years, and has been on this list of Southern California Super Lawyers for the past 5 years.

William Klimon (Chair & Moderator)

William M. Klimon is a Member in Caplin & Drysdale’s Washington, D.C., office. Mr. Klimon joined the firm in 2001 after he had previously practiced in the corporate law departments of two other national law firms. Since 2012, The Legal 500 has listed Mr. Klimon as a leader in his field for Not-for-Profit and
Domestic Tax: East Coast.

Mr. Klimon’s practice focuses on corporate governance and transactions, particularly for nonprofit organizations. Over the last decade, he has advised over 500 nonprofit organizations on a complete range of issues from formation to dissolution, including over a dozen nonprofit mergers. He has worked with many of the nation’s largest private foundations, public charities, political campaigns, environmental organizations, healthcare institutions, universities, libraries, museums, and churches.

Mr. Klimon also practices in the areas of mergers & acquisitions, joint ventures, intercompany lending, and choice of business entities and alternative organizational structures. He has advised a variety of small- and medium-sized partnerships, LLCs, and close corporations, as well as large enterprises including multinational banks, manufacturers, and publishers.

Mr. Klimon is active in the Nonprofit Organizations Committee of the ABA’s Section of Business Law, for which he serves as Co-chair of the Joint Subcommittee on Nonprofit Corporate Governance. He also serves on the Library Committee of the National Sporting Library & Museum, Middleburg, Virginia and was the co-founder of the University of Maryland Chapter of the St. Thomas More Society.