

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

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-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 pursue objectives of the organization that as a director the lawyer opposed. 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 opposition to the action the organization has decided to undertake such that Model Rule 1.7 precludes the representation. The second situation occurs when a lawyer is asked to opine on board actions in which the lawyer participated. Here, there would be a concern that 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 Bus. Law. 387 (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 conflict 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 organization 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 in 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 adviser, 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

liability shield will protect the directors from liability to the organization and its members for money damages unless their conduct is deemed to fall under an exception to the shield. For example, the Model Nonprofit Corporation

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 do 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 legal services provided to a nonprofit organization on a pro bono basis? 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

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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.

Protections for Lawyers

The protections available to directors of nonprofit organizations and lawyers are also available to lawyer/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

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 Client*, 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.