# LAWYERS AS DIRECTORS OF NON-PROFIT CORPORATIONS

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BEYOND THE BASICS: PRACTICAL ISSUES RELATED TO
CHARITABLE GIVING AND NON-PROFIT ORGANIZATIONS

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Congratulations! The movers and shakers in your community have recognized your special abilities and interests and invited you to join the board of directors of an important local non-profit corporation. You are eager to serve, to contribute to the organization's success, to meet new people and to update your resume. However, because you are a lawyer, you have special concerns.

First, you have to keep in mind that if you accept a position on the board, you will really become a director. You will owe the corporation the same duties as any other director. You will be subject to the same corporate policies as the other directors. You will not just be sitting on the sidelines rendering advice or handling specific assignments.

Second, if you do provide legal services to the corporation, you will be both a director and a lawyer and will have to be aware of the special ethical obligations that are imposed upon a lawyer who is also a director of his or her corporate client.

Third, you will now have to consider your duty to the corporation as a director when deciding whether undertaking the representation of a third person with interests adverse to the corporation involves an impermissible conflict of interest.

## 1. A Director's Duties.

1.1 Care and Loyalty. It is generally recognized that directors of non-profit corporations owe to their corporations the same duties of care and loyalty owed by directors of for-profit corporations to their corporations. North Carolina's Non-Profit Corporation Act states that a director must discharge his or her duties as a director (i) in good faith, (ii) with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and (iii) in a manner the director reasonably believes to be in the best interests of the corporation.[1] The ABA's useful *Guidebook for Directors of Nonprofit Corporations*[2] describes the duty of care as the director's obligation (i) to be reasonably informed, (ii) to participate in decisions and (iii) to do so in good faith and with the care of an ordinarily prudent person in similar circumstances.[3] The duty of loyalty obligates

[1] N.C. Gen. Stat. § 55A-8-30(a).
[2] ABA Section of Business Law, *Guidebook for Directors of Nonprofit Corporations* (1998) ("Guidebook").
[3] *Id*. at 21.

each director to act in the interest of the corporation, not in his or her own interest or in the interest of some other person.[4] It requires that a director be conscious of the potential for conflicts of interest and act frankly and carefully in dealing with conflicts of interest.[5] In addition, it requires that before a director engages in a transaction which may be of interest to the corporation, the director must disclose the transaction to the board to give the corporation the opportunity to participate in the transaction.[6] The duty of loyalty also requires that each director respect the confidentiality of information he or she acquires about the corporation during his or her service as a director and not disclose such information unless it is already known by the public.[7]

1.2 Director Conflicts. While falling under the duty of loyalty, the proper resolution of director conflicts of interest is matter of special concern. The North Carolina Non-Profit Corporation Act defines director conflicts of interest and the circumstances under which a transaction involving a director conflict of interest is not voidable by the corporation solely because of a director's interest in the transaction.[8] Usually of greater interest to the directors of a non-profit corporation is the conflict of interest policy adopted by the corporation itself. Such policies generally require directors to disclose personal interests in transactions coming before the board and require a disinterested majority of the board to approve any such transactions, in some cases after application of special scrutiny and an exploration of alternatives. The Internal Revenue Service now encourages non-profit corporations to adopt conflict of interest policies.[9]

2. **Special Ethical Concerns of the Lawyer Who is a Director of His or Her Non-Profit Corporate Client**.

A great deal has been written on the various and sometimes subtle ethical issues that arise when a lawyer serves as a director of his or her corporate client.[10] Many of these issues arise with dual service to a non-profit corporation just as they do with dual service to a for-profit corporation. Here we will touch on the principal ethical issues that arise in this context.

2.1 Pro Bono Clients are Still Clients. It is important for the lawyer who is also a director to keep in mind that the lawyer/client relationship arises in situations when he or she

[4] *Id*. at 28.
[5] *Id*.
[6] *Id*. at 32.
[7] *Id*.
[8] N.C. Gen. Stat. § 55A-8-31.
[9] Although organizations exempt from federal income tax under IRC § 501(c)(3) are not required by statute or regulation to adopt conflict of interest policies, the current form of Application for Recognition of Exemption, Form 1023 (Rev. June 2006), inquires whether the applicant has adopted a conflict of interest policy and includes a model conflict of interest policy. IRS Form 1023, Part V, line 5a and Instructions to Form 1023.
[10] ABA Committee on Ethics and Professional Responsibility, *Formal Opinion 98-410* (1998) ("ABA Opinion"); Task Force on the Independent Lawyer, ABA Section of Litigation, *The Lawyer-Director: Implications for Independence* (1998); Committee on Lawyer Business Ethics of the ABA Section of Business Law, "The Lawyer as Director of a Client," 57 *Business Lawyer* 387 (November 2001); Albert, "The Lawyer-Director: An Oxymoron?," 9 *Georgetown Journal of Legal Ethics* 413 (1996). There are many other scholarly and practical discussions of these issues in print. A copy of the ABA Opinion is appended to this paper as an exhibit.

undertakes to advise the corporation on legal matters without being compensated just as when he or she undertakes to advise the corporation for a fee.[11]

2.2 Competency. Other directors on the corporation's board may feel that any lawyer is competent to handle any legal issue for the corporation and may turn to the lawyer on the board to handle a variety of matters. The lawyer-director must be careful in these situations. Rule 1.1 of North Carolina's Rules of Professional Conduct states that a lawyer must not handle a legal matter that the lawyer knows or should know that he or she is not competent to handle without associating with a lawyer who is competent to handle the matter.[12] Accordingly, the lawyer-director should not attempt to represent the corporation in matters beyond his or her competence just because he or she is requested or given an opportunity to do so by the board.

2.3 Possible Compromise of Professional Judgment. Rule 1.7 of North Carolina's Rules of Professional Conduct[13] deals with conflicts of interest. A comment to Rule 1.7 addresses the special conflicts that may arise when a lawyer serves on the board of a corporate client.

> 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 comprise 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. The lawyer should advise the other members of the board that in some circumstances matters discussed at board meetings while a lawyer is present in the capacity of director might not be protected by the attorney-client privilege and that conflict of interest considerations might require the lawyer's recusal as a director or might require the lawyer and the lawyer's firm to decline representation of the corporation in a matter.[14]

A related ethical issue arises when a lawyer-director is asked to represent the corporation in an undertaking that he or she, as a director, has unsuccessfully opposed. In this situation, the lawyer-director must determine whether his or her representation of the corporation may be "materially limited" by his or her opposition to the action the corporation has decided to undertake such that Rule 1.7(a)(2) would bar the

[11] *Broyhill v. Aycock & Spence*, 102 N.C. App. 382*, aff'd* 330 N.C. 438 (1991).
[12] 27 N.C. Admin. Code 2 1.1.
[13] 27 N.C. Admin. Code 2 1.7. A copy of Rule 1.7 is appended to this paper as an exhibit.
[14] 27 N.C. Admin. Code 2 1.7, comment 35.

representation.[15] In addition, when the lawyer-director is asked to provide advice to the corporation on matters involving prior actions of the board, he or she may be advising on the legality of actions in which he or she has participated as a director. Under these circumstances, as the comment to Rule 1.7 indicates, it may prove difficult for a lawyer to speak independently as counsel to the corporation in light of his or her own interest as a director.[16]

2.4 Disqualification Risk. If a non-profit corporation's board of directors is sued, the lawyer-director may be disqualified from representing the corporation or the other members of the board in the litigation. The lawyer may be a "necessary witness" under Rule 3.7 which generally bars a lawyer from acting as an advocate at a trial in which the lawyer is likely to be a necessary witness.[17] Other directors may assert they relied on the advice of the lawyer-director as counsel. Also, as noted above, the lawyer-director may have interests, as a defendant in the litigation, that materially limit his or her ability to represent the corporate defendant.[18]

2.5 Risk of Loss of the Attorney-Client Privilege. When the lawyer-director is asked to give legal advice to the board, the risk arises that the communication between the lawyer-director and the board will not be protected by the usual attorney-client privilege. This risk is a result of the three largely evidentiary difficulties: (i) proving that the communication related to legal, as opposed to business, advice; (ii) proving that the communication was made as a legal advisor and not as a director; and (iii) proving that the other directors intended their communication to and from the lawyer-director to be a confidential communication with counsel and not merely a discussion among directors.[19] To lessen the risk, the lawyer-director should announce to the board when he or she is giving legal advice in his or her capacity as a lawyer and not acting in his or her capacity as a director. In addition, the lawyer-director and the other directors should take additional steps to protect the privilege such as not including the lawyer's advice in the minutes of the meeting.[20] As noted above, a comment to Rule 1.7 states that the lawyer-director should advise the other members of the board that in some circumstances matters discussed at board meetings while the lawyer-director is present in the capacity of director might not be protected by the attorney-client privilege.[21]

2.6 Who is the Client? With non-profit corporations as with for-profit corporations, there is sometimes confusion concerning the identity of the corporate lawyer's client. Rule 1.13(a) makes it clear that a lawyer retained by an organization represents the organization "acting through its duly authorized constituents."[22] "Constituents" include

[15] See ABA Opinion, *supra*, at III.A. Rule 1.7(a)(2) indicates, in part, that a conflict of interest exists if representation of a client may be materially limited by the lawyer's personal interest.
[16] See ABA Opinion, *supra*, at III.B.
[17] 27 N.C. Admin. Code 2 3.7.
[18] 27 N.C. Admin. Code 2 1.7(a)(2).
[19] See "The Lawyer as a Director of a Client," *supra* at 390.
[20] *Id*.
[21] 27 N.C. Admin. Code 2 1.7, comment 35.
[22] 27 N.C. Admin. Code 2 1.13.

the corporation's officers, directors and employees.[23] The comments to Rule 1.13 indicate that there are times when the corporation's interest may be adverse to the interests of one or more of its constituents.[24] In such circumstances, the lawyer should advise the director, officer or employee that the lawyer cannot represent him or her and that he or she may wish to obtain independent legal representation.[25]

2.7 Liability Insurance. While perhaps not an ethical consideration, whether the lawyer-director will have liability insurance coverage while serving on the board of his or her corporate client is a significant practical concern. The lawyer-director may at first think he or she is well covered when the corporation has director's and officer's insurance coverage and the lawyer has professional liability coverage, but the lawyer-director may be mistaken. Difficult questions concerning coverage may arise because professional liability insurers may specifically exclude coverage for claims which arise when the lawyer is acting as a director of a corporation. At the same time, the corporate D&O policy may have a provision denying coverage to a director when he or she is acting in another capacity, such as a lawyer. As a result, there may be a gray area in which neither coverage may apply.[26]

2.8 Tax Issues. When a legal issue before the lawyer-director is a tax issue, he or she has special concerns. The lawyer-director must observe the standards that apply to tax practitioners in addition to the standards that apply to directors and the standards that apply to lawyers generally.[27] The lawyer-director will often be the first to recognize that in some situations action by a non-profit corporation may expose several different persons to tax liability.[28] In these situations the lawyer-director must consider whether the various persons with potential liability have interests adverse to the corporation and require separate counsel. Special fee concerns also arise for the lawyer-director of a tax-exempt non-profit corporation. The lawyer-director is a "disqualified person" under Section 4958[29] and subject to the tax on excess benefit transactions if the lawyer-director is overpaid for his or her services.[30] While Section 4958 does not apply in the context of private foundations, Section 4941 (concerning self-dealing) contains a similar concept.[31]

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[23] *Id*., comment 1.
[24] *Id*., comment 10.
[25] *Id*. The comment indicates that care must be taken to assure that the individual understands that the lawyer for the corporation cannot provide legal representation for the individual with the adverse interest and that discussions between the lawyer and the individual may not be privileged.
[26] *See* Guidebook at 63.
[27] Treas. Circular 230, 31 CFR, Subtitle A, part 10, sets forth federal tax practice standards applicable to lawyers. For a helpful survey of the ethical aspects of corporate tax representation, see Goldstein & Heuer, "Ethical Disclosure Requirements in Corporate Tax Representations", 33 *Corporate Taxation* 19 (July/August 2006) (part 1 of a 3-part series).
[28] For example, *see* IRC § 4958 (imposing taxes on excess benefit transactions on disqualified persons receiving excess benefit and also on corporate managers participating in the transaction). *See also* IRC § 4941 (imposing taxes for self-dealing on the person transacting business with the private foundation as well as on the foundation manager participating in the act of self-dealing). In certain situations, the non-profit corporation's own exemption from taxation may also be called into question.
[29] IRC § 4958(f)(1)(A); Treas. Reg. § 53.4958-3(c)(1).
[30] IRC § 4958(c).
[31] IRC § 4941(d)(1)(D) and (2)(E).

3. **Representing Others While Serving As A Corporate Director**.

3.1 Conflicts Resulting From Lawyer-Director's Duty to the Corporation. It is obvious that ethical conflicts arise when a lawyer-director who is providing legal services to the corporation is asked to represent someone with an interest adverse to the corporation. Similar conflicts arise when the lawyer does not have the corporation as a client but is merely a member of the board of directors. Rule 1.7(a) provides in part as follows:

> (a) Except as provided in paragraph (b) [concerning informed consent], a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
>
> …
>
> (2) the representation of one or more clients may be materially limited by the lawyer's responsibility to another client, a former client, or a third person, or by a personal interest of the lawyer.[32]

Comments to Rule 1.7 provide further detail about the rule's intended scope.

> Even when there is not direct adverseness, a conflict of interest exists if a lawyer's ability to consider, recommend or carry out an appropriate course of action for the client may be materially limited as a result of the lawyer's other responsibilities or interests.[33]
>
> In addition to conflicts with other current clients, a lawyer's duties of loyalty and independence may be materially limited by responsibilities to former clients under Rule 1.9 or by the lawyer's responsibilities to other persons, such as fiduciary duties arising from a lawyer's service as a trustee, executor or *corporate director*.[34] [emphasis added]

The same conflict of interest principle is illustrated in § 135 of the Restatement of the Law Governing Lawyers:

> Unless the affected client consents to the representation under the limitations and conditions provided in § 122 [concerning consents], a lawyer may not represent a client in any matter with respect to which the lawyer has a fiduciary or other legal obligation to another if there is substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's obligation.[35]

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[32] 27 N.C. Admin. Code 2 1.7. *See also* Rule 1.10 providing generally that while lawyers are associated in a firm, none of them may represent a client when any of them practicing alone would be prohibited from doing so by Rule 1.7.
[33] 27 N.C. Admin. Code 2 1.7, comment 8.
[34] *Id*., comment 9.
[35] Restatement Third of the Law Governing Lawyers, § 135, *The American Law Institute*, 2000.

The comments and illustrations accompanying § 135 of the Restatement describe situations of conflict between a lawyer's duties as counsel and a lawyer's duties as a director when a client asks the lawyer for representation in a matter adverse to the organization.[36] The comment states that because of the lawyer's duties to the corporation, a conflict of interest is present requiring the consent of the clients.[37]

Under Rule 1.7 representation in conflict situations is permitted with consent only in certain circumstances.

> (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
>
> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
>
> (2) the representation is not prohibited by law;
>
> (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
>
> (4) each affected client gives informed consent, confirmed in writing.[38]

In the context of conflicts arising from the lawyer's service as a director, the reference to "each affected client" should be understood to mean not only the lawyer's client but also the corporation of which he or she is a director.

3.2 N.C. Ethics Opinion. North Carolina's one formal ethics opinion on conflicts posed by service as a director of a non-profit corporation reflects Rule 1.7(b)'s definition of conflict and holds out the possibility of resolution through screening and informed consent. 2002 Formal Ethics Opinion 2[39] ("2002 FEO 2") rules that a lawyer may represent a party suing a public body or non-profit organization, although the lawyer's partner or associate serves on the board, subject to certain conditions of disclosure, screening and consent.

2002 FEO 2 deals with six separate inquiries. The first inquiry sets out the facts in the context of a lawyer's service on a Board of County Commissioners. Subsequent inquiries expand the concepts addressed in the first inquiry to a lawyer's service on the board of a non-profit organization.

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[36] *Id*.

[37] *Id*., comment d, illustration 4 (lawyer asked to file a medical-malpractice action against doctor and hospital when lawyer sits on the board of trustees of the university operating the hospital).

[38] 27 N.C. Admin. Code 2 1.7(b).

[39] July 19, 2002 (overruling the holding of RPC 160 that a lawyer whose associate is a member of a hospital's board of trustees may not sue the hospital on behalf of a client).

The opinion describes a situation in which a lawyer is representing a defendant in a condemnation lawsuit filed by the County. Another lawyer from the same law firm is elected to the Board of County Commissioners. The new lawyer-commissioner has disclosed that his law firm colleague represents the defendant in the condemnation suit. He has also volunteered to refrain from consideration or comment on the condemnation action as a member of the Board and has promised to absent himself from meetings in which the condemnation proceeding is discussed and not vote on any issue relating to the matter. 2002 FEO 2 notes that after "full disclosure" from the lawyer-commissioner and upon the advice of its own attorney, the Board unanimously resolved that it did not object to the colleague's representation of the defendant in the condemnation proceeding provided that the lawyer-commissioner continued to avoid action on matters relating to the condemnation proceeding. The firm's client, also after full disclosure, does not object to the representation.

The specific question posed in the first inquiry is whether the colleague may continue as counsel for the defendant in the condemnation action while the lawyer-commissioner serves as a member of the Board of County Commissioners. 2002 FEO 2 concludes that he can, subject to certain conditions. The lawyer-commissioner must be "screened" in his law firm from participation in the condemnation proceeding. The lawyer-commissioner must make full disclosure to the Board of County Commissioners and be screened from participation in the Board's deliberations on the matter. The informed consent of both the Board and the defendant in the condemnation proceeding is also necessary.

"Screening" in the law firm means the law firm must adopt procedures to isolate the lawyer-commissioner from participation in the discussion of the condemnation matter with other members of the firm and from exposure to any confidential information concerning the matter. (Sharing of the legal fee generated by the representation, while not specifically prohibited, is discouraged.)

Screening from participation in the Board of County Commissioners' deliberations on the condemnation proceeding involves the lawyer-commissioner's refraining from any expression of opinion or any communication on the matter, absenting himself from any discussion of the matter by the Board and withdrawing from voting on all issues relating to the matter.

2002 FEO 2 distinguishes a situation where the lawyer-commissioner is named, in an official or individual capacity, as a party to an action. The opinion notes that under those circumstances it is unlikely that the lawyer-commissioner will be able to maintain his neutrality on the Board or within the law firm. 2002 FEO 2 states it is, therefore, a "disqualifying conflict of interest" for the lawyer-commissioner's colleague in the law firm to represent any party in litigation or in any other adversary action if the lawyer-commissioner is a necessary party to the action in either his individual or official capacity.

2002 FEO 2 goes on to describe another set of circumstances where one member of a law firm serves on the board of a non-profit organization and another member of the law firm is representing a client with a claim against the non-profit organization. The question is whether the lawyer serving on the board may continue to serve if his colleague files an action against the organization on behalf of a client. 2002 FEO 2 concludes that subject to the screening and disclosure conditions set forth in the analysis of the situation involving the Board of County Commissioners, the lawyer may continue to serve on the board of the non-profit organization even though another member of his law firm brings an action against the organization. (The opinion seems to assume mutual consent.) 2002 FEO 2 continues on to say that if the situation involves representation of a client in a transaction, rather than in an adversarial proceeding or litigation, the representation may continue if the lawyer serving on the board follows the procedures (apparently, disclosure, consent and screening) spelled out in the opinion.[40]

Note the clear implication that the lawyer-director may not himself represent the client with a claim against the organization or the client involved in a transaction with the organization, even with disclosure and consent. In such situations, screening within the law firm is not possible.

3.3 Ethics Opinions from Other States.

Oregon Form of Ethics Opinion No. 1991-116 (readopted as Form of Opinion 2005-116).[41] The Oregon opinion construes Oregon's version of Rule 1.7 in the context of a charity's lawyer-director who is asked by a donor to represent the donor in making a large gift to the charity and to prepare a will naming the charity as a beneficiary. The opinion holds the lawyer may not represent both the charity and the donor in the gift transaction. It is a non-waivable conflict of interest. The lawyer may represent only the donor in the gift transaction, however, so long as the lawyer obtains informed, written consent from both the charity and the donor. The lawyer may also prepare the client's will so long as the lawyer obtains informed, written consent from both the charity and the client.

Maryland Ethics Docket 2003-08. The Maryland opinion addresses the question of whether a lawyer who chairs his church's legacy committee may prepare, on a *pro bono* basis, wills for parishioners in which the parishioners bequeath property to the church. In applying Maryland's version of Rule 1.7, the opinion holds the lawyer cannot simultaneously serve as a member of the legacy committee and represent parishioners in their estate planning when the parishioners may be considering a gift or bequest to the church. The opinion finds the conflict cannot be resolved by informed consent.

[40] In the situation involving the Board of County Commissioners, the question is stated as may the lawyer-commissioner's colleague continue as counsel for the third party. In the situation involving a lawyer-director of a non-profit corporation, the question is stated as may the lawyer-director continue to serve if a colleague in his firm files an action against the corporation (and later, when the conflict is in a transaction, not an adversary proceeding, whether the colleague's representation of the third party may continue).

[41] August, 2005.

## LIST OF EXHIBITS

1. Rule 1.7, North Carolina State Bar Rules of Professional Conduct, Conflict of Interest: Current Clients

2. ABA Standing Committee on Ethics and Professional Responsibility, Formal Opinion 98-410, Lawyer Serving As Director of Client Corporation

3. North Carolina State Bar 2002 Formal Ethics Opinion No. 2

**EXHIBIT 1**

**Rule 1.7**
**North Carolina State Bar Rules of Professional Conduct,**
**Conflict of Interest: Current Clients**

**Client-Lawyer Relationship**
**Rule 1.7 Conflict of Interest: Current Clients**

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) the representation of one or more clients may be materially limited by the lawyer's responsibilities to another client, a former client, or a third person, or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

# EXHIBIT 2

## ABA Standing Committee on Ethics and Professional Responsibility Formal Opinion 98-410 Lawyer Serving as Director of Client Corporation

AMERICAN BAR ASSOCIATION STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY
Formal Opinion **98-410**
Lawyer Serving as Director of Client Corporation

February 27, 1998

*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. n1 Although some commentators have urged that the practice be prohibited, n2 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. n3

n1 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).

n2 *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) ("at 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).

n3 Model Rule 1.7 Comment [14]. *See also* RESTATEMENT OF THE LAW GOVERNING LAWYERS § 216, Commend *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.

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.

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. n4

n4 The Committee notes that law other than the Model Rules also may govern service of lawyers on boards of directors, including the laws relating to agents and fiduciaries, principles of corporate governance, stock exchange regulations, and rules of the Securities and Exchange Commission. Moreover, while it is permissible under the Model Rules for a lawyer to serve on her client's board of directors, additional risks may, depending on the circumstances, be associated with the dual relationship, especially in the case of public companies. The lawyer and her firm should consider the following risks: (1) possible exclusion of lawyer-directors from D&O policy coverage, except when acting solely as a corporate director; (2) possible exclusion from professional liability coverage, except when acting solely as legal counsel; (3) possible loss of indemnification under some statutes in minority shareholder and derivative actions; (4) possible exposure of 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.

The issues raised when a lawyer serves concurrently as corporate director and counsel are analyzed n5 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.

n5 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.

**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; n6 (2) concerns that the lawyer, 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.

n6 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 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).

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. n7 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.

n7 *See* N.Y. State Bar Assoc. Comm. on Prof. Ethics, Op. 589, 1988 WL 236147 (1988) (lawyer-director must disclose to the client the risk of loss of the attorney-client privilege that results from the lawyer's involvement in the corporation's business decisions).

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 directors 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. n8

n8 For a sample of the issues that a memorandum might discuss, see Susan R. Martyn, *Lawyers as Directors: Who Serves and Why?,* 1996 SYMPOSIUM ISSUE OF THE PROFESSIONAL LAWYER, 1996 A.B.A. CTR FOR PROF. RESP. 113-114.

**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 maintain confidentiality and avoid compromising the attorney-client privilege of the corporation. A

lawyer's duty of confidentiality under Model Rule 1.6 n9 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.

n9 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 impliedly authorized in order to carry out the representation, and except as stated in paragraph (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.

A problem arises, however, as the result of the inconsistent responsibilities of director and lawyer in the application of the attorney-client evidentiary privilege. n10 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.

n10 The privilege exists:

(1) where legal advice of any kind is sought (2) from a professional legal adviser 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 protected (7) from the disclosure by himself or by the legal adviser, (8) except the protection be waived...

8 WIGMORE, EVIDENCE § 2295 p. 554 (1961 rev.). The privilege extends to communications of the type described between a lawyer and her corporate client. See RESTATEMENT *supra* note 3 § 123 (Privilege for Organizational Client).

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 issues or corporate policy. n11 The fact that the lawyer is a director also increases the chances that the privilege may be lost even for purely legal advice. n12 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. n13

n11 *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 coporation'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.)

n12 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.").

n13 *See, e.g.,* United States v. Vehicular Parking Ltd., 52 F. Supp. 751 (D. Del. 1943) (no attorney-client privilege where memorandum from lawyer-director-promoter was essentially 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. n14

n14 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."

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.

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. n15 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." n16 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. n17

n15 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.

n16 Marco v. Dulles, 169 F. Supp. 622, 631 (S.D.N.Y.) *app. dismissed,* 268 F.2d 192 (2d Cir. 1959).

n17 *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).

**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 incorporate actions affecting her as a lawyer or her law firm; and (d) representing the corporation in certain types of litigation.

**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. n18 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.

n18 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.

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. n19 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.

n19 As Illinois State Bar Assoc. Comm. on Prof. Ethics Op. 86-14, 1987 WL 383872, makes clear:

Although 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.

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 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). n20

n20 Rule 1.10(a) states:

(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.

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).

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).

**B. Conflict in Opinion 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 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. n21

n21 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.

**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 "take 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). n22

Formal Op. 1988-5 (under the N.Y. Code of Professional Responsibility). 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.

n22 Comm. on Prof. Ethics of the Assoc. of the Bar of the City of New York, Op. 1988-5 (1988) (under the N.Y. Code of Professional Responsibility).

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. n23 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.

n23 *See* Albert, *supra,* note 2 at 443.

**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, *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. n24 Separate representation also would be required if the claims were derivative or there existed other potential conflicts between the corporation and its directors. n25

n24 *See, 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).

n25 *See* Model Rule 1.13, Comment [11] and N.Y. Ethics Opinion 589, *supra* note 7.

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. n26

n26 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. *See* Comment [5].

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. n27

n27 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 offerings or financial institution investigations. *See supra* note 15 and accompanying text; Alpert, *supra* note 2 at 433-35, 445-49, 457-62.

**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.

**EXHIBIT 3**

**Rule 1.7**

## North Carolina State Bar
## 2002 Formal Ethics Opinion 2
**July 19, 2002**

**Implications of Service on a Public Body or Non-Profit Board**

*Opinion rules that a lawyer may represent a party suing a public body or non-profit organization, although the lawyer's partner or associate serves on the board, subject to certain conditions.*

***Inquiry #1:***

*Attorney A is a lawyer with Law Firm C. He was retained by the defendant in a condemnation lawsuit filed by D County pursuant to Chapter to 40A of the North Carolina General Statutes. Subsequent to Attorney A's entering an appearance in the condemnation proceeding, Attorney B, who is also a lawyer with Law Firm C, was elected to the Board of County Commissioners of D County ("the Board").*

*The Board is the governing body of D County. Neither the Board nor its members are parties to the condemnation proceeding. However, the proceeding was filed at the direction of the Board and the Board has the authority to compromise or dismiss the action. Attorney B disclosed to the Board that Attorney A represents the defendant in the condemnation suit. He also advised the Board that he would refrain from consideration or comment, as a member of the Board, on the condemnation action. He promised to absent himself from meetings in which the matter is discussed and will not vote on any issue relating to the condemnation proceeding. After full disclosure from Attorney B, and upon the advice of its attorney, the Board unanimously resolved that it does not object to Attorney A's representation of the defendant in the condemnation proceeding, provided Attorney B continues to comply with the conditions previously noted. Attorney A's client, after the full disclosure, also has no objections.*

*May Attorney A continue as counsel for the defendant in the condemnation action while Attorney B serves as a member of the Board of Commissioners of D County?*

***Opinion #1:***

*Yes, subject to certain conditions. Lawyers should be encouraged to serve on public bodies, whether by election or appointment, because, by education and experience, lawyers are uniquely qualified for such service. Any barriers to public service by lawyers should be removed if procedures can be established that preserve the ethical values of the profession.*

*To avoid the appearance of impropriety or undue influence, a lawyer who is elected or appointed*

*to a public body must be screened in his law firm from participation in an action brought by another lawyer in the firm against the public body or any subsidiary of that public body. See Rule 6.5 and RPC 53. This means that the law firm must adopt reasonably adequate procedures, under the circumstances, to isolate the lawyer from participation in the discussion of the matter with the other members of the firm and from exposure to any confidential information relative to the matter. Sharing of the legal fee generated by the representation, while not specifically prohibited, is discouraged. Although receipt of the fee by the board member/lawyer may not materially affect his judgment or neutrality, screening from participation in the profit earned from the representation increases the isolation of the lawyer and thereby enhances the public's perception that the lawyer is not exercising undue influence on the other members of the board. Therefore, if practical, a law firm should adopt reasonable procedures for withholding the lawyer's share in the profit (after overhead) from the legal fee earned from the representation.*

*The lawyer serving on the public body must also make full disclosure to the body on which he serves and be screened from participation in the public body's deliberations on the matter. The lawyer must do the following:*

*(1) Disclose in writing or in open meeting to the governing body his relationship to the matter involved;*

*(2) Refrain from any expression of opinion, public or private, or any formal or informal consideration of the matter, including any communication with other members or the staff of the governing body;*

*(3) Absent himself from any discussion of the matter by the governing body; and*

*(4) Withdraw from voting on all issues relating to the matter.*

*CPR 290 and RPC 53. These safeguards will help avoid any inappropriate influence on the other members of the governing body and will protect the lawyer's neutrality. See Rule 6.5(b). Nevertheless, if the lawyer is named, in an official or individual capacity, as a party in the action, it is unlikely that the lawyer will be able to maintain his neutrality on the public body or within the law firm. Therefore, it is a disqualifying conflict of interest for the board member's law partner or associate to undertake the representation of any party in litigation or other adversary action if the board member is a necessary party to the action in either his individual or official capacity. See RPC 53.*

*In RPC 160, the Ethics Committee ruled that a lawyer whose associate is an appointed member of a public hospital's board of trustees may not sue the hospital on behalf of a client. The opinion holds that permitting the lawyer to go forward with the suit against the hospital creates a conflict of interest. However, the opinion fails to distinguish between a suit against the hospital itself and a suit against the members of the board of trustees in their official or individual capacities. In dicta, it is implied that the holding in RPC 160 also pertains to a lawyer whose partner or associate is an elected member of a public governing body but the exact application of RPC 160 to this situation is unclear. For the reasons noted above, RPC 160 is overruled.*

***Inquiry #2:***

*May lawyers at Law Firm C accept new representation adverse to County D provided it does not involve litigation?*

***Opinion #2:***

*Yes, subject to the limitations set forth above, and further subject to the limitation that no lawyer in the firm may undertake the representation of a client if it is known or reasonably should be known that Attorney B will be named, in either his individual or official capacity, as an opposing party in the lawsuit. See RPC 53.*

***Inquiry #3:***

*May lawyers at Law Firm C accept new representations in litigation matters adverse to D County?*

***Opinion #3:***

*Yes, subject to the limitations set forth in Opinion #1 above.*

***Inquiry #4:***

*May lawyers at Law Firm C accept new representations in which the Board itself, or members of the Board in their official capacity, are adverse parties?*

***Opinion #4:***

*See Opinion #1 above.*

***Inquiry #5:***

*Attorney X, another member of Law Firm C, serves on the board of a non-profit organization. Attorney Y, also of the firm, is representing a client with a claim against the organization. May Attorney X continue to serve as a member of the board if Attorney Y files an action against the organization on behalf of the client?*

***Opinion #5:***

*Lawyers should be encouraged to serve on the boards of non-profit organizations for the same reasons that they should be encouraged to serve on government bodies. Therefore, subject to the screening and disclosure conditions set forth in Opinion #1 above, a lawyer may continue to serve on the board of a non-profit organization although another member of the firm brings an action against the organization. RPC 160, as noted above, is overruled.*

***Inquiry #6:***

*Assume that the preceding inquiries concern representation of a client in a transaction rather than representation in an adversarial proceeding or litigation. If another lawyer in the firm serves on a board of the public body or non-profit organization that is a party to the transaction, may the representation continue if the lawyer serving on the board of the public body or non-profit organization follows the procedures set forth in Opinion #1?*

***Opinion #6:***

*Yes.*