NONPROFIT DIRECTOR LIABILITY

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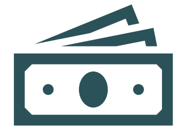
Overview

Non-Profit Corporation Law permits organizations to limit directors' personal liability.

Good Samaritan statutes prohibit director liability for most ordinary negligence.

Directors may be personally liable under Pennsylvania law for:

- Fiduciary breaches; and
- Deepening insolvency.
- These liabilities may include compensatory and punitive damages.



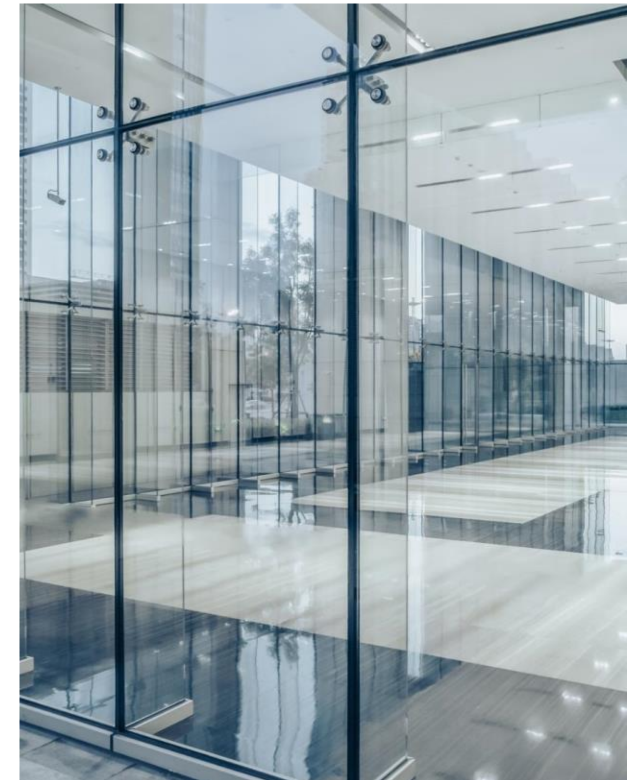
Directors may personally incur tax penalties for:

- Excess Benefit Transactions under Federal tax law; and
- Evading payment of sales tax under Pennsylvania law.

Pennsylvania's Nonprofit Corporation Law of 1988 – 15 Pa. C.S. § 5713

A nonprofit corporation's bylaws may limit a director's personal liability for monetary damages unless:

- The director breached or failed to perform fiduciary duties through self-dealing, willful misconduct, or recklessness;
- The director is culpable in a crime; or
- The director is liable for payment of taxes under Federal, state, or local law.



Pennsylvania's "Good Samaritan Act" - 42 Pa.C.S. § 8332.2(a)

Prohibits civil liability of an uncompensated officer, director or trustee of a public charity for acts or omissions relating solely to performance of their duties, unless:

- Their conduct falls "substantially below" ordinary standards of care; and
- They were aware the act or omission created a substantial risk of actual harm.

Pennsylvania's "Good Samaritan Act" - 42 Pa.C.S. § 8332.2(a) (cont.)

Sewickley Township Volunteer Fire Co. No. 3 v. First Nat'l Bank, No. 3496 of 1988, 1990 Pa. Dist. & Cnty. Dec. LEXIS 166 (Westmoreland Cty. May 11, 1990):

- Granted judgment on the pleadings in favor of officers of a volunteer fire company who did not establish internal financial controls like requiring two signatures for funds withdrawals.
- Plaintiff alleged defendants' actions fell below the ordinary duty of care, but did not allege gross negligence, intentional wrongdoing, wantonness, or that the officers' conduct fell grossly below the standard of care.
- "[§ 8332.2(a)] was intended to absolve from responsibility people… who serve the public without compensation and who, therefore, should not be held to the same standard as those who serve profit-making entities and derive remuneration for their services." Id. at *6-7.
- C.f. Lee v. Sixth Mt. Zion Baptist Church, No. 15-1599, 2016 U.S. Dist. LEXIS 59364, *17-18 (W.D. Pa. May 4, 2016) ("[§ 8332.2] governs liability in tort as it describes the standard for an action in negligence" and "provides no guidance [to a] breach of contract claim.")

Federal Volunteer Protection Act – 42 U.S.C.S. § 14501

- **Statutory Purpose**: "[T]o promote the interests of social service program beneficiaries and taxpayers and to sustain the availability of programs, nonprofit organizations, and governmental entities that depend on volunteer contributions by reforming the laws to provide certain protections from liability abuses related to volunteers serving nonprofit organizations and governmental entities."
- Preempts state laws except those that provide additional protection; states may elect out of civil actions that only involve citizens of that state, by express statutory enactment. Pennsylvania has not done this.
- Prohibits most volunteer personal liability for ordinary negligence.
- Volunteer liability for noneconomic loss may only be in direct proportion to the volunteer's responsibility for the harm.
- Permits only several and not joint liability amongst defendants.
- Exceptions to protections include state laws requiring mandatory training, violent or hate or sex crimes, civil rights violations, or when volunteer was intoxicated.

In re Lemington Home for the Aged Official Comm. Of Unsecured Creditors., 777 F. 3d 620 (3rd Cir. 2015)

- **Arose from the bankruptcy proceeding of an insolvent nonprofit senior citizens' home.**
- **Jury awarded $2,250,000 in compensatory damages against 15 officers and directors, jointly and severally.**
- **Jury awarded $1,750 in punitive damages against two officers and $350,000 in punitive damages against five directors.**
- **The Court of Appeals upheld the jury's fiduciary-breach verdicts that:**
  - *Officers violated their duty of care because they were not compliant with state and federal regulations, were inexperienced, lacked proper qualifications, and kept grossly inadequate financial records;*
  - *Officers violated their duty of loyalty because they were over- compensated, did not work enough, and proposed self-dealing transactions;*
  - *Directors violated their duty of care because they had actual knowledge of the officers' misconduct from multiple independent reports, and of patient harm resulting from that misconduct.*

The Court of Appeals also upheld the jury’s verdict that directors were liable for deepening the insolvency of the organization because they defrauded its creditors by consciously depleting its finances.

- This is a separate cause of action from violating duties of care or loyalty.
- The Appeals Court noted in dicta that a different standard for deepening insolvency may apply for a nonprofit organization than for a for-profit organization, but declined to address that issue because no party raised it.
- This decision was noteworthy in for-profit director liability law as well.

In re Lemington Home for the Aged (Cont.)

The Court of Appeals held that punitive damages may be awarded for defendants' outrageous or malicious conduct without considering their wealth.

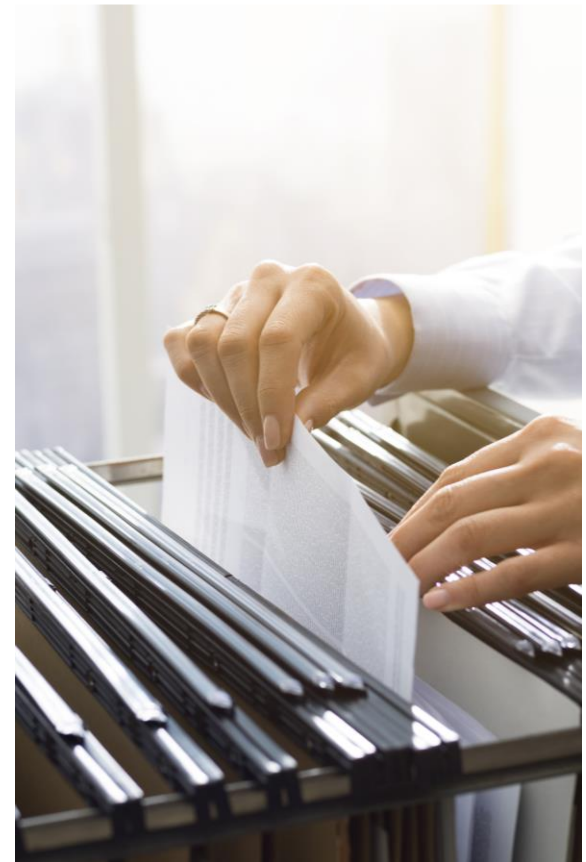
- But the Court vacated the award of punitive damages against the Directors because there was no evidence of their states of mind.
- Boards must balance properly documenting their actions with keeping discrete records.

In re Lemington Home for the Aged (Cont.)

Federal Tax Liability – 26 USCS § 4958

A director may have tax liability from a self-dealing transaction.

- "**Excess Benefit Transaction**": a transaction in which a nonprofit organization provides a Disqualified Person with an economic benefit that has a value that exceeds the consideration (including services provided), received in exchange for such benefit.
- "**Disqualified Persons**": officers, directors, and people who held positions of authority in the organization within the prior five years, and people who have substantial influence including family members of those people.
- A Disqualified Person is liable for a tax equal to 25% of the excess benefit.
- An officer or director of the organization who knowingly participates in an Excess Benefit Transaction is liable for a tax equal to 10% of the excess benefit, up to a maximum of $20,000.
- This applies to 501(c)(3) (charities), (4) (civic leagues), and (29) (co-op health insurers). It does not apply to private foundations.



Pennsylvania Sales Tax – 72 P.S. § 7201

- **Charities, volunteer fire companies, nonprofit educational institutions, and religious organizations are exempt from paying sales tax.**
- **This exemption does not apply to items used by these organizations in an unrelated trade or business or in construction.**
- **A person who willfully attempts to assist another person to evade paying sales tax is liable to pay a penalty of half the amount of the evaded tax. § 7267(b).**
- **There is a broader issue here of when a charitable organization conducts an unrelated trade or business:**
    - *Holding too many small games of chance;*
    - *Selling food or goods as a regular business; or*
    - *Other activities that do not truly have a charitable purpose.*

Recommendations

- Read the bylaws.
- Commit to the mission.
- Do not seek direct personal gain.
- Be careful about:
  - *Vulnerable constituents*
  - *Financially distressed organizations*
  - *Large budgets*
- An accountant or qualified lawyer should vet tax law compliance.
- D&O insurance may not cover liability for a fiduciary breach.

QUESTIONS?

THANK YOU

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Estate of Lemington for the Aged v. Baldwin (In re Lemington Home for the Aged Official Comm. of Unsecured Creditors)

United States Court of Appeals for the Third Circuit

May 14, 2014, Argued; January 26, 2015, Filed

No. 13-2707

Reporter

777 F.3d 620 *; 2015 U.S. App. LEXIS 1183 **; 60 Bankr. Ct. Dec. 138; 2015 WL 305505

In re: LEMINGTON HOME FOR THE AGED OFFICIAL COMMITTEE OF UNSECURED CREDITORS, ON BEHALF OF THE ESTATE OF LEMINGTON HOME FOR THE AGED v. ARTHUR BALDWIN; LINDA COBB; JEROME BULLOCK; ANGELA FORD; JOANNE ANDIORIO; J.W. WALLACE; TWYLA JOHNSON; NICOLE GAINES; WILLIAM THOMPKINS; ROY PENNER; MELODY CAUSEY; JAMES SHEALEY; EUGENE DOWNING; GEORGE CALLOWAY; B.J. LEBER; REVEREND RONALD PETERS, Appellants

Subsequent History: Rehearing denied by, Rehearing, en banc, denied by *In re Lemington Home for the Aged, 781 F.3d 675, 2015 U.S. App. LEXIS 4943 (3d Cir. Pa., Feb. 23, 2015)*

Prior History: [**1] On Appeal from the United States District Court for the Western District of Pennsylvania. (D.C. Civil No. 2-10-cv-0800). District Judge: Honorable Arthur J. Schwab.

Official Comm. of Unsecured Creditors v. Baldwin, 2013 U.S. Dist. LEXIS 70637 (W.D. Pa., May 17, 2013)

Case Summary

Overview

ISSUE: Whether two former officers and fourteen former directors of a nursing home were properly found liable by a jury for breach of fiduciary duties, under *15 Pa. Cons. Stat. § 5712*, and deepening insolvency following the bankruptcy of the nursing home. HOLDINGS: [1]-The jury properly imposed liability findings and punitive damages awards against the administrator and the chief financial officer of the nursing home; [2]-The jury properly imposed liability findings against the directors; [3]-The jury improperly imposed punitive damages against certain directors because the award was not supported by evidence sufficient to establish that they acted with malice, vindictiveness, and a wholly wanton disregard of the rights of others.

Outcome

Jury's liability verdict as to all officers and directors and the punitive damages award against the officers affirmed. Award of punitive damages imposed against certain of the directors vacated.

Counsel: Michael J. Bowe, Esq. [ARGUED], Jennifer S. Recine, Esq., Kasowitz, Benson, Torres & Friedman, New York, NY.

John R. Gotaskie, Jr., Esq., Fox Rothschild, Pittsburgh, PA; Mark R. Hamilton, Esq., Rebecca S. Izsak, Esq., Philip J. Sbrolla, Esq., Cipriani & Werner, Pittsburgh, PA, Counsel for Appellants.

Robert S. Bernstein, Esq., Kirk B. Burkley, Esq., Nicholas D. Krawec, Esq. [ARGUED], Shawn P. McClure, Esq., Arthur W. Zamosky, Esq., Bernstein-Burkley, Pittsburgh, PA, Counsel for Appellee.

Judges: Before: SMITH, VANASKIE, and SHWARTZ, Circuit Judges.

Opinion by: VANASKIE

Opinion

[*624] OPINION OF THE COURT

VANASKIE, *Circuit Judge*.

This lawsuit, which concerns the mismanagement of a Pittsburgh-area nursing home and its ensuing bankruptcy, comes before the Court for a third time on appeal. In the present appeal, the Defendants, two former Officers and fourteen former Directors of the nursing home, present several challenges to the jury's verdict, which found them liable for breach of fiduciary duties and deepening insolvency. The jury also imposed punitive damages against [**2] the two Officers and five of the Directors.

We will affirm the jury's liability findings and the punitive damages award imposed against the Administrator and the Chief Financial Officer of the nursing home. We will, however, vacate the jury's award of punitive damages against the Defendants who served on the nursing home's Board of Directors. We conclude that the punitive damages award against those Defendants was not supported by evidence sufficient to establish that they acted with "malice, vindictiveness and a wholly wanton disregard of the rights of others." *Smith v. Renaut, 387 Pa. Super. 299, 564 A.2d 188, 193 (Pa. Super. Ct. 1989)* (citations omitted).

I.

The Lemington Home for the Aged ("the Home"), established in 1883, "was the oldest, non-profit, unaffiliated nursing home in the United States dedicated to the care of African-America[n] seniors." App. 857. As part of its mission statement, the Home sought to "[e]stablish, support, maintain and operate an institution that is able to extend nursing home care for persons who are infirm due to age and other reasons, without regard to age, sex, race, religion, and to do so regardless of whether such persons themselves have the ability to pay for such care." App. 858.

Defendant Mel Lee Causey was hired to serve as the Home's Administrator [**3] and [*625] Chief Executive Officer in September 1997. Defendant James Shealey became the Home's Chief Financial Officer in December 2002 and reported to Causey.[1] Defendants Arthur Baldwin, Jerome Bullock, Angela Ford, Joanne Andiorio, J.W. Wallace, Twyla Johnson, Nicole Gaines, William Thompkins, Roy Penner, Eugene Downing, George Calloway, B.J. Leber, and the Reverend Ronald Peters all served as members of the Board of Directors of the Home (collectively, "Director Defendants"), and had "direct supervisory control, authority and responsibility" over Causey. App. 859.

The Home had been "beset with financial troubles" for decades, but had remained afloat with help from the City of Pittsburgh, Allegheny County, and donations from several private foundations. *In re Lemington Home for the Aged ("Lemington I"), 659 F.3d 282, 285 (3d Cir. 2011)*. The Home's financial difficulties became particularly acute during the early 2000s, under the management of the Officer Defendants. The Home was cited by the Pennsylvania Department of Health for deficiencies at a rate almost three times greater than the average nursing home operating [**4] in the state. In 2004, Causey began working part-time in her capacity as Administrator, although state law required all nursing homes to employ full-time Administrators. That year, two patients died under suspicious circumstances while residing at the Home, resulting in investigations by the Pennsylvania Department of Health. The Home's patient recordkeeping and billing were in a state of disarray.

On January 6, 2005, the Board convened and voted to close the Home. However, its Chapter 11 petition

[1] When discussed collectively, Shealey and Causey will hereinafter be referred to as the "Officer Defendants."

was not filed until April 13 of that year. During the intervening period, the patient census dropped to as low as 37 patients. "At a Bankruptcy status conference held on June 23, 2005, no one expressed any interest in funding or acquiring the Home," and the Bankruptcy Court therefore approved the Home's closure. *Lemington I, 659 F.3d at 289*. It was later revealed that the Home had "delayed filing its Monthly Operating Reports for May and June until September 2005," although the reports "would have shown that the Home received nearly $1.4 million in Nursing Home Assessment Tax payments," which could have increased its chances of finding a buyer. *Id.*

In November 2005, the Bankruptcy Court granted the request made by the [**5] Committee of Unsecured Creditors ("the Committee") to bring this adversary proceeding against Causey, Shealey, and the Director Defendants claiming breach of fiduciary duty, breach of the duty of loyalty, and deepening insolvency. The District Court granted summary judgment in favor of Defendants on all claims.

On appeal, we vacated the District Court's grant of summary judgment in its entirety, concluding that "our independent review of the record discloses genuine disputes of material facts on all claims." *Id. at 285*. On remand, the District Court set stringent time limits for trial, which the Defendants contested before this Court in a request for a writ of mandamus. We denied the Defendants' request but urged the District Court to consider increasing the time allotted for trial. *In re Baldwin, 700 F.3d 122 (3d Cir. 2012)*.

The District Court increased the time limits and the case proceeded to a six-day jury trial, which began on February 19, 2013. At the close of the Committee's [*626] case, the Defendants moved for judgment as a matter of law, which the District Court granted with respect to the breach of the duty of loyalty claim against the Director Defendants and denied in all other respects. Following the close of trial, the jury deliberated [**6] for three days before returning a compensatory damages verdict against fifteen of the seventeen Defendants, jointly and severally, in the amount of $2,250,000. The jury awarded punitive damages in the amount of $350,000, individually, against five of the Director Defendants. The jury also awarded punitive damages of $1 million against Shealey and $750,000 against Causey.

Following the verdict, the Defendants filed a motion for judgment as a matter of law, a new trial, or remittitur. The District Court denied that motion in its entirety. This appeal followed.

II.

"We exercise plenary review of an order granting or denying a motion for judgment as a matter of law and apply the same standard as the district court." *Lightning Lube, Inc. v. Witco Corp., 4 F.3d 1153, 1166 (3d Cir. 1993)* (citation omitted). "[A] judgment notwithstanding the verdict may be granted under *Fed. R. Civ. P. 50(b)* only if, as a matter of law, the record is critically deficient of that minimum quantity of evidence from which a jury might reasonably afford relief." *Trabal v. Wells Fargo Armored Serv. Corp., 269 F.3d 243, 249 (3d Cir. 2001)* (quotation marks and citations omitted)). "Because the jury returned a verdict in favor of the plaintiff, we must examine the record in a light most favorable to the plaintiff, giving her the benefit of all reasonable inferences, even though contrary [**7] inferences might reasonably be drawn." *Dudley v. S. Jersey Metal, Inc., 555 F.2d 96, 101 (3d Cir. 1977)*.

III.

The Defendants first argue that the Committee introduced insufficient evidence at trial to establish that the Director and Officer Defendants had breached their duty of care and that the Officer Defendants had additionally breached their duty of loyalty. We disagree. The Committee presented evidence to the jury that was sufficient to support a rational finding that the Defendants had breached

their fiduciary duties by failing to exercise reasonable diligence and prudence in their oversight and management of the Home.

A. Officer Defendants

Pennsylvania law provides:

> [A]n officer shall perform his duties as an officer in good faith, in a manner he reasonably believes to be in the best interests of the corporation and with such care, including reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances.

15 Pa. Cons. Stat. Ann. § 5712(c). The duty of loyalty under Pennsylvania law "requires that corporate officers devote themselves to the corporate affairs with a view to promote the common interests and not their own." Tyler v. O'Neill, 994 F. Supp. 603, 612 (E.D. Pa. 1998).

The Committee presented extensive evidence at trial of Causey's mismanagement of the Home in her role as Administrator, [**8] clearly satisfying the "minimum quantity of evidence" required to sustain the jury's verdict on appeal. Trabal, 269 F.3d at 249. The jury heard testimony that it was Causey's responsibility as the nursing home Administrator to:

> make[] sure that there are contracts in place, that the facility is being managed [*627] financially, that bills are being paid, that the nursing staff is adequate in its numbers as well as in their education and training, and that the facility is operating in compliance with both Federal and State regulations, which are really very extensive.

App. 1077.

Evidence presented at trial demonstrated that Causey fell far short of fulfilling these responsibilities. Throughout Causey's tenure, the Home was not in compliance with federal and state regulations. Causey began her role as Administrator in 1997. "[T]here were significant problems identified by the Pennsylvania Department of Health, the inspectors of the nursing home from 1998 through 2004 . . . ." App. 1081. The Home was cited repeatedly for failing to keep proper documentation of residents' clinical records. In 2004, the Department of Health launched an investigation following the death of patient Elaine Carrington. The review concluded that "Causey [**9] lacks the qualifications, the knowledge of the PC regulations and the ability to direct staff to perform personal care services as required." App. 1349-50, 2283. This evaluation, citing Causey's inexperience and lack of qualifications, came after Causey had already been in the role of Administrator for more than six years.

The jury also heard testimony that, at the time of Ms. Carrington's death, Causey was not working at the Home full-time, despite holding the title of Administrator and collecting her full salary. Pennsylvania law requires all facilities of the Home's size to employ a full-time Administrator. But in an application for long-term disability benefits she filed with the state, Causey represented that she was working only "20 to 24 hours per week at Lemington" for more than eight months in 2004. App. 1457. When confronted at trial with this portion of her benefits application, Causey avoided giving a precise figure for how many hours she worked during this period, although she eventually admitted, "I was working part-time." App. 1820.

We are satisfied that the jury was presented with more than sufficient evidence to conclude that Causey breached her duty of care. Additionally, [**10] testimony regarding Causey's self-interested decision to stay on as an Administrator despite being unable to serve full-time as required under state law supported the jury's verdict that she breached her duty of loyalty by collecting her full salary while not in fact fulfilling the duties of the role for which she was being compensated.

The jury also heard sufficient evidence to support its determination that defendant Shealey breached

his duties of care and loyalty as Chief Financial Officer. The Committee presented testimony from William Terrence Brown, a nursing home consultant who had conducted an assessment of the Home on behalf of a major creditor in May 2005. Brown testified that during his review, he requested records from Shealey, including "the latest financial statements, monthly, internally prepared, the annual audits[,] . . . the last year's Medicare and Medicaid cost reports[,] . . . the nursing reports, the census data[,] . . . accounts receivable and accounts payable, [and] aging reports . . . ." App. 1196. Brown testified that he repeatedly asked Shealey for this information, but it was not provided to him.

Brown also testified that, towards the end of his review of [**11] the Home, Shealey, in an attempt to avoid Brown's persistent requests for basic financial information, locked himself in his office. Brown responded by "camp[ing] outside" of Shealey's office, waiting for him to leave in order to speak with him about the Home's finances. App. 1201. Brown testified that [*628] when he finally managed to speak with Shealey:

> I said, Mr. Shealey, there really aren't any books; are there? And he said no.
>
> So I said, well, Mr. Shealey, you got to have something that you keep an idea of what kind of cash is in the bank. So what do you use for that?
>
> And he said, well, I've got, you know, a little Excel spread sheet I use, only I try to keep a bank balance.

Id. When pressed by Brown as to how long he had operated without a general ledger that recorded the Home's finances in detail, Shealey admitted that "June 30, 2004, was the last time they kept any books." *Id.* Brown testified that Shealey never provided him with the Excel spreadsheet he allegedly used in lieu of a general ledger. Despite Shealey's failure to provide these documents to Brown, minutes from a Board meeting following Brown's visit state that Shealey informed the Board that Brown had "received everything he requested." [**12] App. 1870, 3088. Brown also testified that, under Shealey, the Home had failed to bill for Medicare since August 2004. Brown calculated that this resulted in the Home failing to collect at least $500,000 it was due for services rendered. App. 1206.

The Committee also introduced into evidence an email that Shealey sent to a representative of Mount Ararat Baptist Church ("Mt. Ararat") in April 2005, before the Home had filed for bankruptcy. The proposal suggested that Mt. Ararat purchase Lemington "to create a revitalized faith based retirement community" named Mount Ararat Retirement Community ("MARC"). App. 6351. The proposal indicated that Shealey would "assume the position of MARC President and Chief Executive Officer." App. 6360. Director Baldwin testified that he believed Shealey's involvement in this potential sale was inappropriate, as Shealey would receive a benefit if the Home was merged with Mt. Ararat. App. 1303, 1315.

The jury therefore heard sufficient evidence to find that Shealey fell far short of fulfilling his duty to act "with such care, including reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances." 15 Pa. Cons. Stat. Ann. § 5712(c). A person [**13] serving as Chief Financial Officer with reasonable skill and diligence would not fail to maintain a general ledger for over nine months, refuse to meet with a consultant hired by a major creditor of the Home, and forgo collection of upwards of $500,000 due to the Home in Medicare payments. Shealey's decision to stay on as CFO despite his inability to competently fulfill the duties with which he was charged, combined with his proposal that Mt. Ararat purchase the Home and elevate him to the position of President and CEO, also gave the jury a sufficient basis for concluding that Shealey acted in self-interest, breaching his duty of loyalty to the Home.

B. Director Defendants

The evidence also supported a finding that the Director Defendants breached their duty of care by failing to take action to remove Causey and Shealey once the results of their mismanagement became apparent.

Pennsylvania law provides:

> (a) Directors.--A director of a nonprofit corporation shall stand in a fiduciary relation to the corporation and shall perform his duties as a director . . . in good faith, in a manner he reasonably believes to be in the best interests of the corporation and with such care, including reasonable [**14] inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances. In performing [*629] his duties, a director shall be entitled to rely in good faith on information, opinions, reports or statements, including financial statements and other financial data, in each case prepared or presented by any of the following: (1) One or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented. (2) Counsel, public accountants or other persons as to matters which the director reasonably believes to be within the professional or expert competence of such person . . . .
>
> (b) *Effect of actual knowledge*.—A director shall not be considered to be acting in good faith if he has knowledge concerning the matter in question that would cause his reliance to be unwarranted.

15 Pa. Cons. Stat. Ann. § 5712.

The jury heard testimony that the Board was "responsible for the oversight of the nursing home Administrator and for the hiring and firing" of the Home's management staff. App. 1076. The Directors were aware that the Home had "three times the deficiencies" of the average nursing home operating in the state during Causey's tenure as [**15] Administrator. App. 1872. The jury heard testimony that an independent review of the Home in 2001 recommended that, due to the Home's continued citations for health violations, Causey should be replaced with a "seasoned nursing home administrator." App. 1095. The report further urged that "[t]he facility cannot improve overall patient care without a competent administrator on staff . . . ." App. 2210. Although the Board sought and obtained a grant of $178,000 from the Pittsburgh Foundation to fund the search for a new Administrator, the funds were never used to find a replacement for Causey, who remained at the Home despite increasing evidence that her "performance as the nursing home administrator was poor." App. 1095.

Although the date by which the Directors became aware that Causey was working part-time from April through December 2004 was contested at trial, some evidence was introduced that the Board allowed Causey to continue to operate and collect her full salary as Administrator with the knowledge she was working part-time, in violation of state law. Director Andiorio testified that Causey informed the Board that she would be working part-time and the Board did not intervene to replace [**16] her with a full-time Administrator. App. 1867. The jury also heard testimony from Director Baldwin that the Board elevated Shealey into a role as a "CEO type figure" from December 2004 through May 2005, even after the Board discovered that Shealey had not been maintaining proper financial records for the Home in his role as CFO. App. 1297.

This evidence supported the jury's finding that the Director Defendants did not exercise reasonable prudence and care in continuing to employ Causey and Shealey. The Director Defendants kept Causey in the role of Administrator and CEO for six years in the face of abnormally high deficiency findings. Even after she ceased working at the Home full-time, in violation of state law, the Director Defendants allowed Causey to continue in her role as Administrator. This is not a case where directors,

acting in good-faith reliance "on information, opinions, reports or statements" prepared by employees or experts, made a business decision to continue to employ an Administrator whose performance was arguably less than ideal. 15 Pa. Cons. Stat. Ann. § 5712(a). The jury heard testimony that the Director Defendants received several independent reports documenting Causey's shortcomings and urging [**17] [*630] that she be replaced. The Director Defendants therefore had actual knowledge of her mismanagement, yet stuck their heads in the sand in the face of repeated signs that residents were receiving care that was severely deficient. This is enough to support the jury's verdict that the Director Defendants breached their duty of care to the Home.

IV.

The Defendants next argue that the Committee introduced insufficient evidence to support the jury's verdict that the Defendants had deepened the Home's insolvency. "Even when a corporation is insolvent, its corporate property may have value," which can be damaged by "[t]he fraudulent and concealed incurrence of debt . . . ." *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 349 (3d Cir. 2001)*. Thus, we have predicted that Pennsylvania courts would recognize the tort of deepening insolvency, defining it as "an injury to the Debtors' corporate property from the fraudulent expansion of corporate debt and prolongation of corporate life." *Id. at 347*.[2] We are satisfied that the Committee introduced sufficient evidence to support the jury's deepening insolvency verdict.

The Committee presented evidence that the Director Defendants concealed for over three months the Board's January 2005 decision to close the Home and deplete the patient census. In *Lemington I*, we held that this evidence could suggest to a jury that "although the Board knew that its actions would cause further deterioration of the Home's finances to the detriment of its creditors, by its silence, the Board consciously defrauded the Home's creditors by implementing these policies and delaying the filing of bankruptcy . . . ." *659 F.3d at 295*. Trial testimony from Brown, the bankruptcy consultant for the major [**19] creditors, supported the Committee's theory that the Board's decision to deplete the patient census before it filed for bankruptcy resulted in a "slow death" of the Home's ability to generate revenue. App. 1214. The Committee presented additional evidence that, during the bankruptcy process, the Board failed to disclose in its monthly operating reports that the Home had received a $1.4 million Nursing Home Assessment Tax payment in May 2005, which could have increased the Home's chances of finding a buyer. An email from the Board's bankruptcy attorney to the Board summed up the mismanagement of the bankruptcy process, warning that "we have not established a sale process in a manner that is customarily done in Chapter 11 cases. Nobody has had the opportunity to bid and we have no meaningful financial records." App. 3208.

As to the Officer Defendants, the Committee presented evidence that Causey and Shealey's mismanagement of the Home's finances, inattention to recordkeeping and patient billing, and failure to conduct a proper bankruptcy process damaged the already insolvent Home's value. Shealey did not maintain a general ledger of the Home's finances in his capacity as [*631] CFO. As a result [**20] of the patient-documentation errors repeatedly identified by the Pennsylvania Department of

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[2] As they did in *Lemington I*, the Defendants urge us to revisit our prior decision in *Lafferty*, calling to our attention the subsequent decisions of other courts which [**18] have refused to recognize deepening insolvency as a tort. As we observed in response to this argument in *Lemington I*, we continue to be bound to follow *Lafferty* unless it is overturned by our Circuit sitting en banc. 659 F.3d at 294 n.6. We also reserved opining on the question of whether deepening insolvency "may not apply to, or may involve a different standard for, a non-profit corporation," as no party had raised the argument. *Id*. In the present appeal, the Defendants again do not argue that a different standard should apply to deepening insolvency in the non-profit context, so we will not address that question.

Health during Causey's tenure, the Home did not recoup reimbursements it was due for care provided to Medicare patients, resulting in an estimated loss to the Home of $500,000. App. 1085-86, 1206. During the bankruptcy process, Shealey refused to meet with Brown, the consultant hired by the Home's major creditors, and did not make information about the Home's financial condition available to potential buyers. All of this conduct damaged the Home's financial viability after it had already become insolvent. Thus, the jury's verdict on the deepening insolvency claim had ample evidentiary support.

V.

Finally, the seven Defendants against whom the jury imposed punitive damages argue that the jury was not presented with certain factual prerequisites necessary to support a punitive damages award. First, the Defendants argue that there was no evidence introduced of any Defendant's financial status, even though wealth is a relevant consideration for punitive damage awards under Pennsylvania law and the District Court instructed the jury that they could consider the Defendants' wealth in fixing the amount [**21] of punitive damages. The Defendants also argue that the jury was not presented with sufficient evidence of the Defendants' subjective state of mind to justify the imposition of punitive damages.

Although we conclude that wealth evidence is not a necessary prerequisite for an award of punitive damages under Pennsylvania law, we agree that the evidence presented to the jury did not contain the minimum quantum of proof of outrageous conduct necessary to support a punitive damages award against any of the Director Defendants. We will therefore vacate the punitive damages imposed against five of the Director Defendants. However, because we conclude that adequate state-of-mind evidence was presented to support a finding that Shealey and Causey acted "outrageously," we will affirm the jury's punitive damages verdict as to them.

A. Evidence Regarding Wealth of the Defendants

At the close of trial, the District Court instructed the jury on the relevant factors they could consider in fashioning a punitive damages award under *§ 908(2) of the Second Restatement of Torts*, which Pennsylvania has adopted. In particular, the Court instructed the jurors that they could consider "[t]he wealth of the Defendant or Defendants insofar as it is relevant [**22] in fixing an amount that will punish him or her, and deter him or her and others from like conduct in the future." App. 63. However, no evidence of the Defendants' wealth had been introduced to the jury during the trial in any form, either testimonial or documentary.

Defendants argue that the punitive damage award cannot stand because the jury was not presented with any evidence regarding the wealth of any Defendant and therefore could not evaluate what amount of punitive damages would serve as an appropriate deterrent. The wealth of a defendant is indeed one of the three factors that "can properly [be] consider[ed]" by the trier of fact in assessing an award of punitive damages under *§ 908(2)*. Nonetheless, that section's use of the permissive "can," rather than the compulsory "must," suggests that evidence of a defendant's wealth is not a necessary prerequisite to an award of punitive damages. The weight of Pennsylvania case law agrees that "evidence of a tortfeasor's wealth is not a necessary condition precedent for [*632] imposition of an award of punitive damages." *Vance v. 46 and 2, Inc., 920 A.2d 202, 207, 2007 PA Super 71 (Pa. Super. Ct. 2007)* (collecting cases).

Despite *§ 908(2)*'s permissive language, the Defendants urge that evidence of wealth is a necessary prerequisite [**23] to an award of punitive damages. The Defendants point to case law which they claim suggests that the fact finder is required to weigh a defendant's wealth to properly calibrate an assessment of punitive damages. In *Kirkbride v. Lisbon Contractors, Inc., 521 Pa. 97,*

555 A.2d 800 (Pa. 1989), the Pennsylvania Supreme Court rejected a defendant's claim that a punitive damages award must be proportional to an award of compensatory damages, noting that such a requirement would undermine the deterrent purpose of such awards:

> If the purpose of punitive damages is to punish a tortfeasor for outrageous conduct and to deter him or others from similar conduct, then a requirement of proportionality defeats that purpose. It is for this reason that the wealth of the tortfeasor is relevant. In making its determination, the jury has the function of weighing the conduct of the tortfeasor against the amount of damages which would deter such future conduct. In performing this duty, the jury *must weigh* the intended harm against the tortfeasor's wealth. If we were to adopt the Appellee's theory [of proportionality to compensatory damages], outrageous conduct, which only by luck results in nominal damages, would not be deterred and the sole purpose of a punitive damage award would [**24] be frustrated.

Id. at 803 (emphasis added).[3]

Although the reasoning of the *Kirkbride* decision evinced a concern with ensuring that a punitive damages award must be sufficiently large to deter future wanton conduct by a wealthy defendant, a decision from the Eastern District of Pennsylvania has interpreted *Kirkbride*'s language as a limitation on a court's ability to impose punitive damages absent any evidence of the defendant's wealth. In Rubin Quinn Moss Heaney & Patterson, P.C. v. Kennel, 832 F. Supp. 922, 936 (E.D. Pa. 1993), the District Court noted as a [**25] consideration in its decision declining to impose punitive damages that "the record is devoid of evidence concerning [the defendant's] wealth." Citing *Kirkbride*, the District Court concluded that it was "required to assess the impact the [punitive] damages would have on the Defendant's financial position," which it could not do given the state of the record. *Id.*

The weight of the Pennsylvania appellate case law, however, interprets Kirkbride differently and concludes that evidence of wealth is not required to assess punitive damages under Pennsylvania law. In *Vance*, the Superior Court of Pennsylvania rebuffed a claim that *Kirkbride* "requires that the jury be presented with evidence of a tortfeasor's wealth before they can impose punitive damages." 920 [*633] A.2d at 206. The Superior Court noted that *Kirkbride* was concerned with the distinct question of whether "an award of punitive damages had to be proportional to, or bear a reasonable relationship to, an award of compensatory damages." *Id.* Although the *Vance* court acknowledged that "wealth of the tortfeasor is a relevant consideration in effectuating the purpose of punitive damages," it concluded that "*Kirkbride* does not stand for the proposition that [**26] a jury cannot impose punitive damages without evidence of record pertaining to the defendant tortfeasor's wealth." *Id.* The Superior Court later reaffirmed this holding in Reading Radio, Inc. v. Fink, 2003 PA Super 353, 833 A.2d 199, 215 (Pa. Super. Ct. 2003), which held that "the polestar for the jury's assessment of punitive damages is the outrageous conduct of the defendants, not evidence of a defendant's wealth." Similarly, in Shiner v. Moriarty, 706 A.2d 1228, 1242 (Pa. Super. Ct. 1998), the Superior Court "reject[ed] the suggestion that evidence of net worth is mandatory" to impose

[3] *Kirkbride*'s holding that a punitive damage award does not need to be proportional to the compensatory damages assessed in a given case has been subsequently called into question by a string of Supreme Court cases holding that, as a matter of due process, "courts must ensure that the measure of punishment is both reasonable and proportionate to the amount of harm to the plaintiff and to the general damages recovered." State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 426, 123 S. Ct. 1513, 155 L. Ed. 2d 585 (2003). The Defendants do not press a constitutional due process claim regarding punitive damages as a part of this appeal, so we will "decline to resolve the thorny issue presented by the apparent conflict" between *Kirkbride* and the Supreme Court's subsequent pronouncements on proportionality in punitive damage awards. Tunis Bros. Co. v. Ford Motor Co., 952 F.2d 715, 741 (3d Cir. 1991).

punitive damages.

In light of the aforementioned decisions and the permissive, rather than compulsory language of *§ 908(2)*, we agree with the District Court that Pennsylvania law does not require evidence of a defendant's wealth before punitive damages may be imposed. For whatever reason, parties may make the strategic decision to not introduce such evidence at trial, and that decision is not a basis for vacatur of a punitive damages award on appeal.

B. Evidence of Outrageous Conduct by Defendants

"'Punitive damages may be awarded for conduct that is outrageous, because of the defendant's evil motive or his reckless indifference to the rights of others.'" *Feld v. Merriam, 506 Pa. 383, 485 A.2d 742, 747 (Pa. 1984)* (quoting *Restatement (Second) of Torts, § 908(2)*). "Punitive damages . . . are not awarded to compensate the plaintiff for her damages but rather to [**27] heap an additional punishment on a defendant who is found to have acted in a fashion which is particularly egregious." *Phillips v. Cricket Lighters, 584 Pa. 179, 883 A.2d 439, 446 (Pa. 2005)* (citation omitted). "The state of mind of the actor is vital. The act, or the failure to act, must be intentional, reckless or malicious." *Feld, 485 A.2d at 748*. "[W]e must make a 'careful analysis of the entire trial record' and examine whether the plaintiffs provided sufficient evidence to support a punitive damage award." *David by Berkeley v. Pueblo Supermarket of St. Thomas, 740 F.2d 230, 237 (3d Cir. 1984)* (quoting *Berroyer v. Hertz, 672 F.2d 334, 341, 19 V.I. 641 (3d Cir. 1982))*. "'[F]or punitive damages to be awarded there must be acts of *malice, vindictiveness and a wholly wanton disregard of the rights of others.*'" *Tunis Bros., 952 F.2d at 741* (quoting *Smith, 564 A.2d at 193*) (emphasis added).

1. Director Defendants

As to the Director Defendants—Andiorio, Baldwin, Thompkins, Johnson, and Bullock—insufficient evidence was presented to support a finding that any of them possessed a sufficiently culpable state of mind to warrant the imposition of the "extreme remedy" of punitive damages, which Pennsylvania courts have cautioned should be awarded "in only the most exceptional matters." *Phillips, 883 A.2d at 445*. In its decision affirming the punitive damages award against five of the Director Defendants, the District Court pointed to the same conduct that it held had supported the compensatory damages award against [**28] all of the Director Defendants. Specifically, the District Court noted the Board's failure to replace Causey despite awareness of her poor performance as Administrator, the Board's [*634] January 2005 decision to close the Home which was not disclosed until April, and the mismanagement of the bankruptcy process by the Board. App. 42-43. Explaining the jury's potential rationale for imposing punitive damages against only five of the members of the Board, the District Court concluded that, based on its "detailed review of the exhibits," the Director Defendants against whom punitive damages were awarded had "received more correspondence relating to the closure of the Home than the other Defendants against whom liability was imposed, but no punitive damages were assessed." App. 43-44. The amount of information individual directors knew is certainly relevant to establishing their liability for inaction and fraudulent nondisclosure. Nevertheless, we do not think that, on its own, evidence of the receipt of correspondence provided the jury with a sufficient basis to conclude that any of the five Director Defendants had engaged in "a quantum of outrageous conduct *in addition* to that undergirding [**29] the . . . liability . . . ." *Tunis Bros., 952 F.2d at 741* (emphasis added).

Our decision in *Donaldson v. Bernstein, 104 F.3d 547 (3d Cir. 1997)*, in which we sustained a punitive damages award against a debtor's two principals who had engaged in self-dealing, provides a helpful point of contrast. Unlike the evidence in that case, no evidence was presented in this matter that the Directors against whom the jury assessed punitive damages acted out of self-

interest. Indeed, in a decision that the Committee does not appeal, the District Court directed a verdict in favor of all of the Directors on the Committee's claim that they had breached their duty of loyalty to the Home. App. 1677. The District Court therefore found the record could not possibly support an inference that the Directors' conduct was motivated by the intention to extract a personal profit at the expense of the best interests of the Home. *See* In re Lampe, 665 F.3d 506 (3d Cir. 2011) (directors' duty of loyalty prohibits them from "directly or indirectly, utiliz[ing] their position to obtain any personal profit or advantage other than that enjoyed also by their fellow shareholders" (quoting Tyler, 994 F. Supp. at 612)). The absence of evidence of self-dealing by any of the Director Defendants weighs heavily against the imposition of the "extreme" remedy of punitive damages.

[**30] Moreover, the District Court acknowledged that three of the Director Defendants against whom punitive damages were imposed—Thompkins, Johnson, and Bullock—were mentioned only fleetingly during the course of trial testimony. The District Court cast the failure to call Thompkins, Johnson, and Bullock as witnesses, or to ask questions of other witnesses about their conduct, as a strategic decision made by both parties, similar to the decision to not present testimony regarding the Defendants' financial statuses. But unlike evidence of a defendant's wealth, which "is not a necessary condition precedent for imposition of an award of punitive damages," Vance, 920 A.2d at 207, evidence of "outrageous or malicious conduct" is a necessary "legal and factual prerequisite" for a punitive damages award. Tunis Bros., 952 F.2d at 740. Therefore, it is the plaintiff who bears the burden of proving that the defendants' conduct was outrageous in order to obtain a punitive damages award. A vacuum of evidence at trial on this topic does not affect both sides equally; rather, plaintiff loses, having failed to carry her burden.

In light of the lack of state-of-mind evidence presented by the Committee regarding the Director Defendants against whom the jury imposed punitive damages, we will [*635] vacate the jury's award of punitive damages against those five Defendants.

2. Officer Defendants [**31]

We have no such concerns about the punitive damages assessed against the Officer Defendants. The mismanagement of the Home by Causey and Shealey was the focus of the Committee's proof at trial. As detailed above, the Committee presented sufficient evidence at trial to sustain the jury's verdict that both Officer Defendants breached their duty of loyalty to the Home. In *Donaldson*, we held that evidence of self-dealing by trustees provided sufficient factual support for imposition of a punitive damages award. 104 F.3d at 556-57. Likewise, the evidence of self-dealing presented at trial gave the jury a sufficient factual basis to conclude that the Officer Defendants acted with the outrageous motive of pursuing self-enrichment at the expense of the non-profit nursing home to which they owed fiduciary duties.

In addition to the evidence of self-dealing, the Officer Defendants' state of mind was illuminated by their own testimony at trial. Both Causey and Shealey responded evasively under cross-examination to questions about their conduct, allowing the jury to infer that they had acted culpably and continued to avoid recognizing the gravity of their misconduct. For instance, the Committee questioned Causey [**32] about the apparent conflict between her state-benefits application and her trial testimony regarding how much time she had worked during an eight month period in 2004. Causey first attempted to claim that she had worked "a minimum of 35 hours a week," as required by state law, throughout this period. App. 1819. When reminded that she had signed a state-benefits application "under penalties of law" claiming that she was working just 20 to 24 hours a week during the same period, Causey admitted, "I was working part-time." App. 1820. Similarly,

Shealey conceded at trial that he had refused to give Brown, the bankruptcy consultant for the creditors, the financial information he requested. Although Shealey initially claimed this was because Shealey "didn't know who [Brown] was," he later acknowledged that he had continued to refuse to cooperate even after being informed that Brown was a financial consultant. App. 1556-57. Taken together with the other evidence of their malfeasance, Causey and Shealey's obfuscations at trial offered further support for the conclusion that they had acted outrageously, supporting the jury's imposition of punitive damages against them.

VI.

For the foregoing reasons, [**33] we will affirm the jury's liability verdict as to all Defendants and the punitive damages award against the Officer Defendants. We will vacate the award of punitive damages imposed against Defendants Andiorio, Baldwin, Thompkins, Johnson, and Bullock.

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Vacco v. Diamandopoulos

Supreme Court of New York, New York County

April 6, 1998, Decided

Index No. 401253/97

Reporter
185 Misc. 2d 724 *; 715 N.Y.S.2d 269 **; 1998 N.Y. Misc. LEXIS 716 ***

Dennis C. Vacco, as Attorney General of the State of New York, Plaintiff, v. Peter Diamandopoulos et al., Defendants.

Case Summary

Procedural Posture

In an action brought by plaintiff, Attorney General, to hold the individual defendants, former university trustees, financially accountable for mismanagement of the university's assets, defendants filed motions to dismiss, motions for indemnification, and motions to stay the action pending determination of a related proceeding.

Overview

This action was commenced by plaintiff, Attorney General, to hold the individual defendants, former university trustees, financially accountable for mismanagement of the university's assets. Plaintiff also sought partial return of a retainer paid to defendant law firm. Defendants moved to dismiss certain causes of action. An individual defendant also moved to dismiss certain other causes of action. The individual defendants also sought advance indemnification, and to stay the action pending determination of a related proceeding. The court denied defendants' motion for advance indemnification and for a stay of proceedings. The court also denied the motions to dismiss and ordered defendants to serve an answer to the complaint within 10 days after service of a copy of this order. The court found that the complaint contained the necessary allegations that defendants were guilty of bad faith. The court also found that the complaint pleaded sufficient facts from which it could be found that one defendant caused or permitted himself to receive compensation in violation of his duty to act in good faith, by receiving excessive reimbursement for travel and entertainment.

Outcome

In an action by plaintiff, Attorney General, to hold the individual defendants, former university trustees, financially accountable for mismanagement of the university's assets, the court denied defendants' motions to dismiss, motions for indemnification, and motions to stay the action pending determination of a related proceeding. The court found that the complaint contained the necessary allegations that defendants were guilty of bad faith.

Counsel: [***1] *Robinson Silverman Pearce Aronsohn & Berman L. L. P.,* New York City (*Herbert Teitelbaum* of counsel), for Peter Diamandopoulos, defendant. *Arkin Schaffer & Kaplan L. L. P.,* New York City (*Stanley Arkin* of counsel), for Ernesta Procope and others, defendants. *Dennis C. Vacco, pro se,* and *Elizabeth M. Guggenheimer,* New York City, for Dennis C. Vacco, plaintiff.

Judges: CHARLES EDWARD RAMOS, J.S.C.

Opinion by: CHARLES EDWARD RAMOS

Opinion

[*725] [**270] Charles Edward Ramos, J.

This action was commenced by the Attorney

General to hold the individual defendants, former members of the Board of Trustees of Adelphi University, financially accountable for mismanagement of the assets of the University, in violation of the [**271] Not-For-Profit Corporation Law. The Attorney General also seeks partial return of a retainer paid to defendant Arkin, Schaffer & Kaplan L. L. P. (Arkin Schaffer). Defendants, excluding defendant Peter Diamandopoulos, move to dismiss plaintiff's twenty-eighth through thirty-first causes of action. Defendant Peter Diamandopoulos moves to dismiss plaintiff's fifth, ninth, fourteenth, twenty-second, twenty-fourth and [***2] twenty-eighth causes of action.

The individual defendants also seek advance indemnification pursuant to *N-PCL 724*, and to stay this action, pursuant to *CPLR 2201*, pending determination of a related CPLR article 78 proceeding in Supreme Court, Albany County.

The individual defendants are all former members of the Board of Trustees of Adelphi University, a private, not-for-profit, nonsectarian educational corporation operating under a charter granted by the New York State Board of Regents. Peter Diamandopoulos, in addition to being a trustee, was president of the University. Arkin Schaffer is a law firm representing all the former trustees except Diamandopoulos.

In the fall of 1995, the Charities Bureau of the Attorney General's office began to investigate various matters at Adelphi, including Diamandopoulos' compensation package. In 1996, at the request of the Committee to Save Adelphi (CSA), the Board of Regents began a separate investigation, and selected a three-member panel to preside over a hearing on CSA's petition to remove the entire Board of Trustees. The hearing was held over the course of 27 days, during the period between [***3] July 30 and November 20, 1996. The trustees retained [*726] counsel for their defense, whose fees were paid by Adelphi. In February 1997, shortly before the Board of Regents issued its decision, the trustees retained the law firm of defendant Arkin Schaffer. A retainer fee of $ 250,000 was paid by Adelphi. On February 5, 1997, the panel circulated a report and recommendation to the full Board of Regents. On February 10, the Board of Regents adopted the report, ordering the immediate removal of 18 of the 19 trustees, and replacing them with new trustees selected by the Regents. The former trustees filed an article 78 proceeding, and won a stay of the Regents' determination, thereby remaining in power. Shortly thereafter they withdrew the proceeding without prejudice, and relinquished their positions on the Board. Subsequently, they recommenced an article 78 proceeding. That proceeding was pending at the time this motion was submitted, but was subsequently dismissed as untimely.

Adelphi's new Board, through its law firm, Paul Weiss Rifkin Wharton & Garrison, demanded that Arkin Schaffer return the unspent portion of the retainer. Arkin Schaffer responded that the former [***4] trustees are entitled to have their attorneys' fees paid to challenge the Regents' determination and to defend them in a potential lawsuit by the Attorney General, who had been authorized by the Regents on March 11 to initiate litigation, and that the retainer was properly paid. However, Arkin Schaffer offered to pay the money to Paul Weiss to be held in escrow for payment of attorneys' fees. Before the matter of the retainer was resolved, the Attorney General brought this action.

The claims raised in this action are based upon the allegedly excessive compensation package given to defendant Peter Diamandopoulos, improper utilization of the insurance brokerage service of E.G. Bowman & Co., improper usage of the LOIS/USA advertising services, improper purchasing of goods and services, improper indemnification, and improper retainer of Arkin Schaffer.

After commencement of this action, the former trustees sought confirmation from Adelphi's replacement Board that the attorneys' fees paid by Adelphi to defend them constituted proper indemnification under Adelphi's bylaws and the indemnification statute. They also sought advance [**272] indemnification pursuant to N-PCL 723 (c) [***5] for the defense expenses to be incurred in the present action and the related article 78 proceeding challenging the Regents' decision. Adelphi's attorneys responded that the confirmation regarding indemnification [*727] for fees already paid was premature because there had not been a final disposition of the Regents' proceeding or this lawsuit. They also declined to advance expenses for attorneys' fees to be incurred in the future.

Defendants move to dismiss the twenty-eighth cause of action for failure to state a claim for relief. That cause of action alleges that: "By causing or permitting University assets to be paid for defense costs to the trustees in the Attorney General's investigation and the proceeding to quash or compel compliance with his subpoenas and in the proceedings before the Regents of the University of the State of New York, defendant trustees indemnified persons who had not acted in good faith for a purpose reasonably believed to be in the best interests of the corporation, in violation of N-PCL § 722."

N-PCL 722 provides for a corporation to indemnify a director or officer for, *inter alia,* attorneys' fees incurred as a result of an action brought [***6] against them in their capacity of a director or officer of the corporation. Indemnification is authorized where the director or officer "acted, in good faith, for a purpose which he reasonably believed to be in, or ... not opposed to, the best interests of the corporation" (N-PCL 722 [a]). Accordingly, if the bylaws of Adelphi permit indemnification, it would be authorized where the director or officer acted in good faith.

The bylaws of Adelphi provide that: "Each Trustee and Officer of the University shall be indemnified against all expenses actually and necessarily incurred by such Trustee or Officer in connection with the defense of any action, suit, or proceeding to which he or she has been made a party by reason of being or having been such Trustee or Officer except in relation to matters as to which such Trustee or Officer shall be adjudicated in such action, suit, or proceeding to be liable for gross negligence or willful misconduct in the performance of duty." The statute and the bylaws must be construed together. If the trustees acted in good faith, were not found to have acted wrongfully in the performance of their duties and did not personally gain a financial profit [***7] to which they were not legally entitled, they would be entitled to indemnification, pursuant to N-PCL 722 and Adelphi's bylaws.

With respect to the compensation package of the University president, the Regents found that "the trustees failed to exercise the degree of care and skill that ordinarily prudent persons would have exercised in like circumstances," and that they "failed to exercise due care to ensure that Diamandopoulos' compensation package as a whole was 'reasonable' and [*728] 'commensurate with the services performed,' as required by N-PCL § 202 (a) (12)." With respect to the use of the insurance brokerage services of former Trustee Procope, the Regents found that "Procope and Diamandopoulos neglected their fiduciary duties to Adelphi," and that "Diamandopoulos' actions were not consistent with his duties of undivided loyalty and care to Adelphi." The Regents concluded that Diamandopoulos and Procope should be removed from the Board "for neglect of their duties of due care and loyalty." The Regents did not address whether the insurance fees were reasonable.

Reviewing the use of former Trustee Lois' advertising firm, the Regents found "that Lois neglected both [***8] his duties of due care and undivided loyalty to Adelphi," and that he "violated his fiduciary duty by failing to disclose to the board

that lois/usa was, indeed, being paid for services rendered to Adelphi." The Regents concluded [**273] that Diamandopoulos and Lois should be removed "for neglect of their fiduciary duties of due care and loyalty." The Regents also found "that the full board of trustees neglected its duty of due care to Adelphi by failing to take appropriate action once it learned of Procope's and Lois' potential conflicts." They recommended removal of the 18 trustees "for neglect of their duty of due care." The Regents did not address whether Lois' company received excessive payment for the work which was done.

The Regents found that Diamandopoulos neglected his duty as trustee with respect to the purchasing of goods and services for the University by failing to disclose to the audit committee facts pertinent to their review of the University's purchasing department. His failure to reveal information was found to constitute "neglect of duty."

The Regents also found that the trustees failed in their duty to abide by and implement the Articles of Governance, [***9] which call for faculty participation in the governance of the University, particularly with respect to academic matters and related educational policies and procedures. The Regents recommended the removal of the trustees for neglect of duty on this basis as well.

The complaint (and the Regents' findings) contains the necessary allegations that the trustees were guilty of bad faith. Therefore, accepting the allegations in the complaint as true, and giving the plaintiff the benefit of every reasonably conceivable inference, as must be done in a motion to dismiss (*Leon v Martinez, 84 NY2d 83* [1994]), bar dismissal of the complaint at this stage. In addition the former trustees may [*729] not have followed the proper procedures for authorizing indemnification. Accordingly, defendants' motion to dismiss the twenty-eighth cause of action of the complaint is denied.

The defendants requested that Adelphi pay for the cost of their legal defense in this lawsuit; Adelphi refused the request. Accordingly, the defendants seek to have this court order Adelphi to advance the reasonable expenses to be incurred in defending this litigation, as provided for in *N-PCL [***10] 724 (c)*. The Attorney General and Adelphi oppose this application, claiming that the defendants are not entitled to such advance indemnification due to their grossly negligent conduct, and extreme breaches of fiduciary duties. The Attorney General also contends that the University's financial situation is fragile, and that advancing the money at this time could prove too much of a financial strain.

N-PCL 724 (c) provides: "Where indemnification is sought by judicial action, the court may allow a person such reasonable expenses, including attorneys' fees, during the pendency of the litigation as are necessary in connection with his defense therein, if the court shall find that the defendant has by his pleadings or during the course of the litigation raised genuine issues of fact or law."

Given the scope of the findings of neglect of duty by the Regents, this court finds the granting of such indemnification not to be warranted.

Defendants seek dismissal of causes of action twenty-ninth, thirtieth and thirty-first which seek restitution from Arkin Schaffer for the unspent portion of the retainer paid in February 1997. The causes of action are based on conversion, unjust enrichment, [***11] and money had and received.

In order to state a claim for unjust enrichment, the plaintiff must plead facts alleging that Arkin Schaffer was enriched, and that under the circumstances, equity and good conscience require that the money be returned. (*Simonds v Simonds, 45 NY2d 233, 242* [1978]; *Chemical Bank v Equity Holding Corp., 228 AD2d 338* [**274] [1st Dept 1996].) Innocent parties may also be unjustly enriched (*Simonds v Simonds, supra*), so Arkin Schaffer's innocence of wrongdoing is irrelevant to the inquiry.

Here, Arkin Schaffer received a retainer fee from the former trustees. In order to conclude that there was no unjust enrichment, there must be a finding that the money was properly given to Arkin Schaffer. Given this court's determination above, this portion of the motion to dismiss is denied.

[*730] The Attorney General also alleges a claim based upon conversion. To establish a cause of action for conversion, the complaint must allege facts demonstrating that Adelphi had legal ownership or an immediate superior right of possession to specific identifiable personal property, and that Arkin Schaffer [***12] exercised unauthorized dominion over the property to the exclusion of Adelphi's rights. (*See, Aetna Cas. & Sur. Co. v Glass, 75 AD2d 786* [1st Dept 1980].) There must be a specific identifiable fund and an obligation to return it in order for an action for conversion to lie. (*Manufacturers Hanover Trust Co. v Chemical Bank, 160 AD2d 113, 124* [1st Dept 1990].)

There is no evidence before the court as to whether the retainer was placed in a separate account; therefore, the issue of whether it constitutes a specifically identifiable fund cannot be determined. This portion of the motion is denied with leave to renew.

The defendants seek a stay of this action pending the outcome of an article 78 proceeding seeking annulment of the Regents' determination. Since the petition was subsequently dismissed, that portion of the motion is denied as moot.

Diamandopoulos contends that the fifth cause of action must be dismissed because the complaint fails to allege facts to support a conclusion that he caused himself to receive compensation and benefits, or that he withheld information or otherwise misled the Board when his compensation was determined. [***13] Further, Diamandopoulos argues that the Attorney General fails to assert any factual allegations as to how he caused Board action when he was only one member of the Board. Additionally, he points out that the complaint itself alleges facts in contradiction to such a claim, by stating that there was an Executive Compensation Committee which determined Diamandopoulos' salary without the involvement of the other trustees, so Diamandopoulos could not have been involved in the determination.

The fifth cause of action alleges that: "[b]y causing or permitting himself to receive compensation and benefits from University assets in the amounts alleged, defendant peter diamandopoulos failed to discharge his duties as trustees [*sic*] of Adelphi University in good faith, in violation of *Section 717 of the N-PCL*." The Attorney General claims that Diamandopoulos placed his own self-interest above that of the University by accepting increasingly high levels of compensation while the University was facing serious problems. He further claims that Diamandopoulos had tremendous influence over the other [*731] trustees, and that Procope, who was chair of the Executive Compensation Committee, [***14] was undoubtedly seeking to curry favor with Diamandopoulos since Diamandopoulos picked her insurance company to handle Adelphi's insurance needs. Further, the complaint alleges that almost all of the trustees who served on the Executive Compensation Committee, beginning in 1993, were chosen by Diamandopoulos. The Attorney General also contends that Diamandopoulos' use of an unrestricted expense account resulted in Diamandopoulos "causing or permitting" University assets to be used for expenses in an unreasonable way.

The complaint contains sufficient allegations from which it can be inferred that he [**275] had significant influence on the members of the Executive Compensation Committee. Furthermore, Diamandopoulos' use of the benefits, particularly his expense account, is subject to scrutiny. The complaint alleges, *inter alia,* that Diamandopoulos began to travel abroad at the University's expense, in first class, often with his wife, despite the fact

that his initial employment contract provided for reimbursement only for domestic travel, and that he was reimbursed over $ 360,000 for travel and entertainment expenses for the period of January 1, 1993 through June 30, 1996.

[***15] Even accepting Diamandopoulos' argument that he did not set his own compensation, he was still obligated to act in good faith with respect to his utilization of an expense account. The fact that the other trustees may have been negligent in failing to oversee his expenses does not relieve him of his duty to act in good faith. Therefore, accepting the allegations in the complaint as true, and giving the plaintiff the benefit of every reasonably conceivable inference, the complaint pleads sufficient facts from which it could be found that Diamandopoulos caused or permitted himself to receive compensation in violation of his duty to act in good faith, by receiving excessive reimbursement for travel and entertainment. Therefore, the motion to dismiss the fifth cause of action is denied.

Diamandopoulos contends that the ninth cause of action must be dismissed because there are no allegations to support the claim that: "[b]y permitting the purchase by the University of a condominium apartment in Manhattan for his personal use and occupancy, defendant diamandopoulos failed to discharge his duties as trustees [*sic*] of Adelphi University in good faith in violation of *Section 717 [***16] of the N-PCL*."

However, the Attorney General alleges that the Board authorized the purchase of the Manhattan apartment for development [*732] purposes, but it was used instead largely as Diamandopoulos' Manhattan home. He claims that Diamandopoulos permitted the purchase knowing that it would be used primarily as a personal residence rather than for its authorized purpose. The Attorney General places great emphasis on the fact that Diamandopoulos recommended the purchase to the Finance Committee, and began searching for an apartment prior to the Board's authorization of the purchase. The Board failed to evaluate any other less costly alternatives to achieving the objective of a "Manhattan presence," or to investigate how the apartment they had previously rented had been used, or whether Adelphi had benefited from the rental of the prior apartment in New York City. The Attorney General further alleges that Diamandopoulos took advantage of his situation by furnishing and renovating the apartment to his liking at University expense, and sought reimbursement for $ 4,000 per year in holiday gratuities to the apartment staff.

There are allegations that Diamandopoulos exerted [***17] undue influence over the Board in order to cause it to purchase the apartment, and there are allegations that Diamandopoulos was responsible for appointing the members of the Finance Committee, which could possibly have tainted their recommendation to the entire Board. Therefore, the motion to dismiss the ninth cause of action is denied.

The fourteenth cause of action claims that: "[b]y causing or permitting the University to enter into a contract of sale with a delayed closing date with himself for the purchase of the condominium apartment in Manhattan, defendant peter diamandopoulos failed to discharge his duties as trustees [*sic*] of Adelphi University in good faith in violation of *Section 717 of the N-PCL*."

The complaint alleges that approximately 10 months after purchasing the apartment, the Board offered Diamandopoulos a contract of sale with a delayed closing date [**276] under which he was given the right to purchase the apartment at any time, up to within 15 days of his separation from Adelphi, for $ 905,000. This portion of the motion is also denied.

The twenty-second cause of action states: "By causing or permitting the University to purchase advertising [***18] services from or through lois/usa, defendant peter diamandopoulos failed to

discharge his duty as trustee of Adelphi University in good faith in violation of Section 717 of N-PCL."

The twenty-fourth cause of action alleges: "By causing or permitting the University to purchase advertising services [*733] from or through LOIS/USA, DEFENDANT GEORGE LOIS AND DEFENDANT PETER DIAMANDOPOULOS violated Section 715 of N-PCL by failing to disclose to the full Board of trustees the material facts of defendant Lois' interest in those transactions, and the full Board did not otherwise have knowledge of those facts."

The complaint alleges that in December 1994, the full Board unanimously approved an advertising campaign presented by Lois, which was to be executed by Lois' agency, LOIS/USA. At a March 8, 1995 Board meeting, Diamandopoulos thanked Lois for "giving his services, free of charge, to the University." It further alleges that the Board did not know that it was only the creative cost of the work that was donated until June 1996. The Regents' report found that Diamandopoulos knew that Lois' firm was receiving commissions from advertisements they placed on Adelphi's behalf, but failed [***19] to report that information to the Board.

If the allegations in the Regents' report and those in the complaint are taken as true, as they must be on a motion to dismiss (*see*, Leon v Martinez, 84 NY2d 83, *supra*), the allegations support the twenty-second and twenty-fourth causes of action. Therefore, Diamandopoulos' motion to dismiss those causes of action is denied.

Accordingly, it is hereby ordered that defendants' motion for advance indemnification is denied; and it is further ordered that defendants' motion for a stay of these proceedings is denied as moot; and it is further ordered that the motions to dismiss are denied; and it is further ordered that defendants are directed to serve an answer to the complaint within 10 days after service of a copy of this order with notice of entry and to appear at Part 53 on May 6, 1998 at 9:30 A.M. for the purpose of entering into a preliminary conference/compliance conference order.

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Philly Nonprofit Execs Lived Large On Co. Money, Jury Told

By **P.J. D'Annunzio**

Law360 (March 18, 2024, 11:06 PM EDT) -- Jurors should not believe arguments from two nonprofit executives who are former associates of City Councilman Kenyatta Johnson who said they simply made bookkeeping mistakes and didn't concoct an alleged scheme to spend company money on things like huge bonuses, lavish vacations and bribing a Milwaukee school official, federal prosecutors said Monday.

At closing arguments before U.S. District Judge Gerald A. McHugh, prosecutors attempted to convince the jury that Shahied Dawan and Abdur Rahim Islam, who were indicted for embezzling from their organization, conspired to misspend funds from the tax-exempt Universal Cos., a nonprofit operating two charter schools in Philadelphia started by famed R&B record producer Kenny Gamble, who is not a defendant in the case.

Prosecutors alleged Universal CEO Islam and Chief Financial Officer Dawan not only overpaid themselves and sent Islam on trips to Orlando and Jamaica, but that Universal paid $10,000 to Milwaukee school board director Michael Bonds — allegedly disguised as book purchases — to help them open a charter school in that city. Bonds pled guilty to bribery-related charges in 2019.

Assistant U.S. Attorney Linford C. Wright told the jury that Islam and Dawan took Gamble's dream of improving his Philadelphia community through education and affordable housing, and used it for personal gain.

"They were the individuals who were supposed to bring this vision to fruition, but I suggest to you they supported this vision until they didn't," Wright said. "And the vision became something very different."

The pair "let the good times roll," Wright said, going down a list of expenses charged to Universal, which allegedly included putting up Islam in a Ritz-Carlton, buying several pricey bouquets for a woman, and expensive meals — all of which Dawan signed off on, according to the government.

"You can't be Big Willy on somebody else's' dime. You can't live a high life with somebody else's money," Wright said. "That money was meant to support children."

When they came close to running out of money, Islam approached Bonds to help them survive by opening a third school in Milwaukee, Wright said. He claimed Islam used the nonprofit's money to buy a collection of books from Bonds, which in reality was meant to pay for Bonds' vote on the school board.

Wright said that Bonds, who testified for the prosecution, accepted the payment because he was mired in healthcare debt and also had to foot the bill for his son's legal troubles.

Islam's attorney, David M. Laigaie, assailed Bonds' credibility in his closing argument, claiming Bonds cooperated with the government only in exchange for leniency. Laigaie also said the government failed to prove a quid pro quo between Islam and Bonds.

Laigaie also scoffed at the idea of an overarching conspiracy, arguing to the jury that it would

make no sense for fraudsters to document all of their allegedly illegal expenses like the defendants did.

Instead, he said, any bookkeeping discrepancies were mistakes, the result of Islam being overworked and buried in his duties as the leader of Universal.

"Mr. Islam was insanely busy," Laigaie said.

He used a complex expense tracking system for logging expenses and put off filing them until the very last minute, Laigaie said.

Looking back, Laigaie said, Islam "should have delegated it to someone who could've done it in a timely manner."

Laigaie also argued that the government made a big deal about Islam's travels, but never said that he didn't work during those trips, which would justify the expense.

Dawan's attorney, Thomas O. Fitzpatrick likened the government to a bully he faced as a child, one who chased him up to the porch of his home. Like the lawyer's childhood bully, the government has power and needs to be confronted in this case, he said.

Echoing Laigaie's statements about faulty bookkeeping, Fitzpatrick said, "There may be poor governance; there is no criminal conspiracy."

When Universal was in dire financial straits, Dawan drew from his home equity to support the company, Fitzpatrick said, noting he wouldn't have done that just for Islam to take a vacation to Jamaica.

"Universal was his life's work," Fitzpatrick said. "When the company was in trouble, he took the money for his home and put it in Universal."

"This is a good man on trial," Fitzpatrick added.

Prior to the superseding indictment forming the basis for the current trial, Islam and Dawan were charged alongside Johnson and Johnson's wife, Dawn Chavous, in January 2020. In that indictment, federal authorities accused Johnson of using "councilmanic privilege" — a practice where city council members influence land use decisions in their districts — to pass legislation giving an advantage to Islam and Dawan's low-income housing development and charter school enterprise, Universal Cos.

The government alleged Dawan and Islam bribed Johnson to get the "spot-zoning" legislation passed. However, in the first part of the two-part trial, **all defendants were acquitted** on Nov. 2, 2022.

The government is represented by Mark B. Dubnoff, Frank R. Costello Jr. and Linwood C. Wright Jr. of the U.S. Attorney's Office of the Eastern District of Pennsylvania.

Islam is represented by David M. Laigaie, Jessica K. Southwick and Joshua D. Hill of Eckert Seamans Cherin & Mellott LLC.

Dawan is represented by Thomas O. Fitzpatrick of Mincey Fitzpatrick Ross LLC.

The case is USA v. Islam, case number 2:20-cr-00045, in the U.S. District Court for the Eastern District of Pennsylvania.

--Editing by Lakshna Mehta.

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Ethics Opinion 382

Lawyer-Directors Representing Entity-Clients

Introduction
The Legal Ethics Committee has received several inquiries regarding whether a lawyer who represents an entity-client may also serve as a member of the client's board of directors.[1] The Committee is aware that acting in such dual capacities is a common practice that often accrues to the benefit of both lawyer and client and is not generally prohibited[2] but, as former Supreme Court Justice Potter Stewart warned, there are significant ethical issues implicated by such dual service's intertwining "the function of the lawyer in giving professional counsel" and "the function of corporate management . . . in the profit-making interests of its stockholders."[3]

At its core, the essential ethical issues relating to a lawyer representing a client-entity also serving as a director on the entity's board are conflicts of interest that may arise between two or more of: (1) the lawyer's duties to the entity as its counsel; (2) the lawyer's fiduciary duties to the entity as a director; and (3) the lawyer's personal self-interest inherent in simultaneously serving in both roles.[4]

For example, a personal conflict might arise for the lawyer-director when:[5]

- the lawyer-director is asked for legal advice regarding her own acts or omissions that she took in her directorial capacity;
- the lawyer-director is asked for legal advice regarding different potential courses of action, and she prefers one option as a board member;
- the lawyer-director is asked to represent a client whose interests are directly adverse to the entity;
- the lawyer-director is, or may be, called as a witness by those bringing lawsuits against the entity-client;[6]
- the lawyer-director is employed by a law firm and serves as outside counsel to the entity, and the board must deliberate with respect to the relationship between the firm and the entity, including deciding whether to retain the firm, the fees to be paid to the firm, when and whether to retain the firm's services, etc.;
- a lawsuit is brought against the corporation and its directors, and the interests of the board are adverse to those of the corporation or adverse to the interests of the lawyer-director.[7]

The purpose of this Opinion is to create a roadmap for practitioners to navigate the ethical and practical issues of such dual service.

The Committee concludes that while there is no per se proscription against a lawyer representing an entity while simultaneously serving as a director of that entity, the lawyer must first carefully determine whether the additional fiduciary or other responsibilities related to serving on the entity's board creates a material risk of compromising the lawyer's independence of professional judgment on behalf of the client or otherwise creates a personal or other conflict of interest. This determination must include full and frank discussions with the client of all material risks inherent in the lawyer serving in such a dual role and obtaining the entity-client's informed consent thereto.[8]

The Committee notes that it may be more practical for the lawyer-director to recuse herself from representing the entity-client or from giving it legal advice while serving on its board as an effective way to avoid most, but not all,[9] of the types of conflicts discussed herein. Where consistent with the rules, the lawyer-director may suggest that the client agree to a different lawyer from her firm representing it while she serves as a director, which would minimize, but not eliminate, the ethics issues discussed herein.

Applicable Rules

- Rule 1.0 (Terminology)
- Rule 1.1 (Competence)
- Rule 1.2 (Scope of Representation)
- Rule 1.4 (Communication)
- Rule 1.6 (Confidentiality of Information)
- Rule 1.7 (Conflict of Interest)
- Rule 1.8 (Conflict of Interest: Specific Rules)
- Rule 1.10 (Imputed Disqualification: General Rule)
- Rule 1.13 (Organization as Client)
- Rule 5.7 (Responsibilities Regarding Law-Related Service)

General Discussion

Unlike accountants, who are prohibited by the Code of Professional Ethics for Certified Public Accountants from serving on boards of directors of their entity-clients,[10] neither the ABA Model Rules of Professional Conduct nor the D.C. Rules bar lawyers from serving in such a dual capacity, but they warn lawyers to decline such representations in circumstances where there exists a material risk that the lawyer's independent judgment will be compromised or where there is a disqualifying conflict.[11]

The duties of a corporate director to shareholders do not overlap cleanly with the duties that a lawyer owes a client under the D.C. Rules of Professional Conduct. As such, the lawyer must provide information to the entity-client sufficient for it to be aware of the potential risks inherent in an attorney serving such dual roles and make clear to the client at all times "which hat she is wearing."

An attorney-client relationship may unintentionally arise when the entity reasonably believes that the lawyer-director is acting as its counsel in providing legal advice. As such, it is important for a lawyer to take every reasonable step to avoid such misconceptions and to clarify his role at every stage. When acting pursuant to his duties as a board member, the attorney must make clear that he is not acting as a lawyer or giving legal advice. On the other hand, when the lawyer is acting as counsel to the entity-client, he must take every reasonable step to ensure that it understands that he represents only the entity and that he does not represent any of its board members, officers, employees, or anyone else.[12] Best practices include specifying this important point to the client both through specific and unambiguous language in the retainer agreement consistent with Rule 1.5 and thereafter when required by Rules 1.4 and 1.13.

There are several additional ethical issues that arise in the context of a lawyer serving a dual role on behalf of the entity-client, particularly the risk that her professional judgment could be compromised. As a stark – but not at all uncommon – example, a lawyer-director might be required to determine the legality of the board's decisions in which she directly participated; in such situations, her ethical obligation to provide competent, diligent, objective, and independent legal advice could be at odds with her personal and managerial interests.[13] Moreover, while it is not uncommon for an entity to agree prospectively to limit the liability of its directors, a lawyer who decides to also serve as a director could not make any agreement that prospectively limits the lawyer's liability to a client for malpractice.[14]

As such, a lawyer considering assuming a dual role on behalf of an entity must first assess whether assuming such a dual role is ethically permissible and, if so, discuss these issues with the client-entity and, together with it, determine, based upon a risk-benefit or other appropriate analysis, if assuming a dual role is appropriate under the circumstances.[15]

Discussion

Rule 1.2 (Scope of Representation)

Pursuant to Rule 1.2(a):

> A lawyer shall abide by a client's decisions concerning the objectives of representation … and shall consult with the client as to the means by which they are to be pursued. . . A lawyer shall abide by a client's decision whether to accept an offer of settlement of a matter. In a criminal case, the lawyer shall abide by the client's decision, after consultation with the lawyer, whether to waive a jury trial, and whether the client will testify.

Thus, the Rule carefully distinguishes between the *objectives* of the representation, such as whether to accept a settlement or request a jury trial or plea, which vest generally in the client, and the *means* of obtaining those objectives, which vest generally in the lawyer: As Comment [1] to the Rule elaborates:

> Both lawyer and client have authority and responsibility in the objectives and means of representation. The client has ultimate authority to determine the purposes to be served by legal representation, within the limits imposed by law and the lawyer's professional obligations. Within these limits, a client also has a right to consult with the lawyer about the means to be used in pursuing those objectives. At the same time, a lawyer is not required to pursue objectives or employ means simply because the client may wish that the lawyer do so. A clear distinction between objectives and means sometimes cannot be drawn, and in many cases the client–lawyer relationship partakes of a joint undertaking. In questions of means, the lawyer should assume responsibility for technical and legal tactical issues, but should defer to the client regarding such questions as the expense to be incurred and concern for third persons who might be adversely affected . . .

This distinction creates an issue for the lawyer-director, who at all times must be conscious of this important "objectives vs. means" distinction. As counsel to the entity, he must abide by the decisions of his client regarding the objectives of the representation[16] even if, as a director, he powerfully disagrees with the client's decision in that regard. Moreover, as counsel, he may exercise his best legal judgment and decline to follow the entity's instructions with respect to the means of the representation, even if the client urges such action. However, so long as the decision of the entity acting through its duly authorized constituent(s)[17] is both legal and ethical, the lawyer, in his capacity as a director, must follow the client's directions regarding even the means of the representation, even if he strongly believes that such action is not in the client's best interests.

As discussed more fully below, this dichotomy on the objectives-means continuum between a lawyer-director's prerogatives and duties as a lawyer and as a director creates potential personal conflicts of interest for lawyers wearing both hats.

Rule 1.1 (Competence)

Pursuant to Rule 1.1, lawyers must provide competent representation to their clients and must possess the "legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation." Some courts have ruled that a director for an entity who is also a lawyer is held to a higher standard of care than a non-lawyer director and, as such, must be careful to recognize "red flags" for potential legal issues in a company's operations which may not be apparent to a non-lawyer director.[18]

Moreover, unlike lawyers who advise a company but do not also serve as directors, lawyer-directors might know the intimate details of the entity-client's internal operations.[19] This heightened standard of care means that the lawyer-director faces a greater potential risk of violating Rule 1.1 when the lawyer is also representing the entity.

Finally, although it is generally outside the scope of the authority of the Legal Ethics Committee to comment on matters of substantive law, it is important to remind practitioners that they are bound by the substantive law,[20] and that their duty of competence under Rule 1.1 includes the duty to be

familiar with all applicable laws and regulations. Again, in this regard, lawyer-directors should be aware that courts have often held them to substantially higher standards of care and due diligence under various SEC Rules than other directors.[21]

Rule 1.13 (Organization as Client) and Rule 1.4 (Communication)

Rule 1.13 establishes that a lawyer for an organization represents only the entity itself, "acting through its duly authorized constituents," who could be any person or persons designated by the entity-client to act in that capacity. As such, the duly authorized constituent is merely an agent for the entity with respect to the representation, and the full scope of the lawyer's ethical duties run directly to the entity itself, and not to any of its directors, officers, owners, employees, shareholders, or to any other persons or constituents.

There may be situations where one or more fellow directors is engaged in an action, intends to act, or refuses to act in a matter related to the lawyer-director's representation that is a violation of law which reasonably might be imputed to the organization and is likely to result in substantial injury to the organization. Under such circumstances, Rule 1.13(b) mandates that the lawyer proceed "as is reasonably necessary in the best interests of the organization," including referring the matter "to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law."[22]

When a lawyer is also a director, it may be particularly uncomfortable and difficult for her to "report up" on her fellow directors – perhaps even as to the acts or omissions of the duly authorized constituent – with whom she has established a working relationship and perhaps friendships. Nevertheless, when the interests of management or the board or any of its directors diverge from that of the entity, the lawyer-director is bound by Rule 1.13 to prioritize the interests of the entity and to act only in its best interests.

Moreover, above and beyond Rule 1.13, a lawyer-director has the same duty as any other lawyer to ensure that all client decisions be made "only after the client has been informed of all relevant considerations."[23] Thus, if a lawyer who represents an entity-client is also considering serving on the client's board, he must provide all information that the entity will need to make an informed decision as to whether to invite the lawyer to serve as a director for the entity as well. Such information that must be discussed with the entity-client includes, at the very least, the fact that certain communications with the board by a lawyer who is also a director may not be protected by the attorney-client privilege.[24]

By virtue of the close working relationship with her fellow directors, the lawyer-director may actually obtain more information to communicate to the client and to draw on when advising the client. However, some confusion may result when a lawyer also serving as a director learns information that a non-director lawyer would not have known; again, Rule 1.4 would also require that the lawyer-director relay this information to the client to the possible detriment of the board.

Rule 1.6 (Confidentiality of Information) and Rule 5.7 (Responsibilities regarding Law-Related Services)

The duty of a lawyer to protect client confidences and secrets under the D.C. Rules is a fundamentally important obligation which, subject to very few exceptions, generally takes priority over other ethical imperatives. That particularly broad duty extends not only to confidential attorney-client communications but also to "secrets," which Rule 1.6(b) defines as "other information gained in the professional relationship that the client has requested be held inviolate, or the disclosure of which would be embarrassing, or would likely to be detrimental, to the client." However, the client holds the privilege and the entity-client and/or its directors may waive the attorney-client privilege and consent to the disclosure of the entity's confidences and secrets.

There are any number of communications by a lawyer that are legally protected from disclosure by applicable substantive law of attorney-client privilege but which are not afforded similar protection for communications from a director to his entity. As such, confusion may arise regarding which hat the lawyer--director is wearing; under which circumstances, in his role as lawyer, he is obligated to protect certain private information; and when, in his role as director, he is required to make disclosures.

The general rule is that *legal* advice is protected by the attorney-client privilege and Rule 1.6, but *business-related advice* is not always protected and is potentially discoverable in litigation.[25] The repercussions of this distinction may be dire; for example, given the different scopes of the fiduciary and attorney-client privileges with regard to confidential information, the lawyer-director may be forced to turn over information during discovery or potentially testify as to information that would have been covered by attorney-client privilege had the lawyer not also been a director.[26]

Distinguishing between these roles can be complex because the discussion may oscillate between legal advice and business discussions and also because a bright line between "legal" and "business-related" may not always exist, making legal advice provided by a lawyer-director more vulnerable to involuntary disclosure or subject to mandatory disclosure than that of a lawyer who is not also a director.[27] As such, when the lawyer-director must discuss legal matters which he would like to make subject to the attorney-client privilege, it may be insufficient to declare that "I am speaking now in my capacity as legal counsel." Rather, he must take affirmative and substantive steps to make plain the strictly legal nature of the discussion.

Although often impractical and difficult to achieve, the lawyer-director could consider having entirely separate sessions with his entity-client where only legal issues are discussed and where other firm lawyers and inside general counsel are purposely included in such meetings. Though the subject of attorney-client privilege substantive law is beyond the scope of this opinion, the lawyer-director might consider the crafting of meeting minutes so as to avoid revealing client confidential information in privileged discussions with entity counsel.

Moreover, Rule 5.7, which imposes additional duties upon a lawyer who provides "law related services," applies particularly to lawyer-directors. Rule 5.7(b) defines law-related services as “services that might reasonably be performed in connection with and in substance are related to the provision of legal services, and that are not prohibited as unauthorized practice of law when provided by a nonlawyer.” As Comment [9] explains:

> A broad range of economic and other interests of clients may be served by lawyers engaging in the delivery of law-related services. Examples of law-related services include providing title insurance, financial planning, accounting, trust services, real estate counseling, legislative lobbying, economic analysis, social work, psychological counseling, tax preparation, and patent, medical or environmental consulting.

When a lawyer provides general legal services to the entity, but also provides only business advice to the entity in a particular case, Rule 5.7 will apply:

- (a) A lawyer shall be subject to the Rules of Professional Conduct with respect to the provision of law-related services, as defined in paragraph (b), if the law-related services are provided:
  - (1) By the lawyer in circumstances that are not distinct from the lawyer’s provision of legal services to clients; or
  - (2) In other circumstances if the lawyer fails to take reasonable measures to assure that a person obtaining the law-related services knows that the services are not legal services and that the protections of the client–lawyer relationship do not exist.

Thus, Rule 5.7 creates an additional mandate under the D.C. Rules that a lawyer-director be careful at all times to remember which "hat" he is wearing – lawyer or director – and to be meticulous in communicating with the entity-client to make clear which role he is playing at a particular time.[28] This is particularly important, and the risk of confusion is particularly severe, where the recipient of services lacks sophistication.[29]

Rule 1.7(b)(4) (Conflicts of Interest: General Rule)

Many lawyers think of “conflicts” as those that arise between two or more current clients or between a current and former client.[30] It goes without saying that, in undertaking any representation of an entity-client – whether as only in his capacity as lawyer or as a lawyer-director – the lawyer must always conduct a competent and thorough conflicts check against current and previous representations as he would ordinarily do in every representation. However, for a lawyer-director, disqualifying conflicts may not involve conflicts between two or more clients but, rather, conflicts that are personal to him.

The analysis of such conflicts begins with Rule 1.7(b)(4):

> (b) Except as permitted by paragraph (c) below, a lawyer shall not represent a client with respect to a matter if: . . .

(4) The lawyer's professional judgment on behalf of the client will be or reasonably may be adversely affected by the lawyer's responsibilities to or interests in a third party or the lawyer's own financial, business, property, or personal interests.

(Emphasis added).

This rule has very broad applicability; a lawyer has a Rule 1.7(b)(4) conflict not only where there exists an actual personal conflict, but even in cases where the lawyer's professional judgment on behalf of a client "may be adversely affected by the lawyer's responsibilities to or interests in a third party or the lawyer's own financial, business, property, or personal interest." (Emphasis added). Such personal conflicts undermine the lawyer-director's capacity to render objective, detached advice because he will be – or even may be – personally affected by the legal advice he renders.[31]

However, even when a lawyer-director has a personal conflict, it may still be ethically permissible for him to represent the entity-client if he can meet both requirements of Rule 1.7(c):

> (c) A lawyer may represent a client with respect to a matter in the circumstances described in paragraph (b) above if
> (1) Each potentially affected client provides informed consent to such representation after full disclosure of the existence and nature of the possible conflict and the possible adverse consequences of such representation; and
> (2) The lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client.

As Comment [7] explains:

> The underlying premise is that disclosure and informed consent are required before assuming a representation if there is any reason to doubt the lawyer's ability to provide wholehearted and zealous representation of a client . . . Although the lawyer must be satisfied that the representation can be wholeheartedly and zealously undertaken, if an objective observer would have any reasonable doubt on the issue, the client has a right to disclosure of all relevant considerations and the opportunity to be the judge of its own interest.[32]

Thus, after a good faith effort to determine which conflicts of interest may exist, the lawyer must obtain the client's informed consent[33] before taking on a dual role.[34] However, in the context of resolving personal conflicts, it is very important for the lawyer-director seeking to represent the entity-client to carefully consider the implications of Rule 1.6, the duty to maintain and protect client confidences and secrets, in seeking such informed consent. If, for the consent by the entity-client to be "informed," the lawyer would be required to disclose Rule 1.6-protected information from another client (current or past), the lawyer would be ethically prohibited from doing so. The result would be that the lawyer could not obtain the requisite informed consent; she could not satisfy Rule 1.7(c)(1); she therefore could not remove the taint of her Rule 1.7(b)(4) personal conflict; and she would be precluded from representing the entity-client in that matter.

Moreover, some lawyers erroneously conclude that obtaining the client's informed consent effectively resolves a personal interest conflict. In fact, pursuant to Rule 1.7(c)(2), the lawyer must also undertake *both* a subjective self-assessment and an objective analysis[35] to determine whether – notwithstanding the client's informed consent – he will be able to provide competent, diligent, and zealous representation to the client notwithstanding his own interests. In the language of Legal Ethics Opinion 365:

> the lawyer must [subjectively] hold such a belief and that belief must be reasonable under an objective standard . . . the prohibition of Rule 1.7(b)(4) is one which is highly dependent on the circumstances of the representation and the lawyer's own circumstances . . . we can do no more than identify the conflict of interest considerations, and leave it to the inquirer to determine whether the particular circumstance of his representation of his client are such that his judgment "will be or reasonably may be affected . . ."

The analysis is not complete, however, because even when the lawyer-director has a personal conflict such that she cannot satisfy either the objective or subjective test of Rule 1.7(c)(2), she may nonetheless continue to serve as counsel to the entity-client if she can limit the scope of her representation so as to "carve out" the personal conflict.

Pursuant to Rule 1.2, a lawyer may eliminate the taint of a personal conflict by limiting the scope of the representation when such limitation is "reasonable under the circumstances" and the "client gives informed consent." As such, a lawyer-director may limit the scope of her representation when her directorial role undermines, or has the capacity to undermine, her judgment on behalf of the client-entity. In some circumstances, she may step out of one of her roles on behalf of the entity, or she may either withdraw from serving as counsel for the entity and advising it on the problematic issue (and recommend substitute counsel to advise the entity for that limited purpose) or abstain from her role as a board director when the board addresses and acts on the problematic issue.

In instances involving specific discrete matters, such as determining the lawyer's compensation and whether to retain the lawyer's firm to represent the entity in certain matters, such a limitation is both feasible and reasonable. In other cases, however, where the taint of the personal conflict will permeate virtually everything the lawyer does in representing the entity – such as, for example, when she is asked to represent the corporation in a lawsuit in which both she and the board are defendants – such a limitation will generally not remove the taint of the personal conflict, even if the entity-client gives informed consent to the representation.

Finally, pursuant to Rule 1.10(a)(1),[36] a lawyer's personal conflicts are not ordinarily imputed to her firm. Therefore, when the lawyer-director has a personal conflict with respect to a particular matter, another lawyer at the firm may be able to represent the entity-client with respect to that matter – unless the personal interest of the conflicted lawyer "presents a significant risk of adversely affecting the representation of the client by the remaining lawyers in the firm."

As such, any firm lawyer seeking to replace a lawyer-director from his firm who has been disqualified from representing the entity because of a personal conflict must undertake his own Rule 1.7(b)(4) analysis as discussed above to determine if he, too, has a conflict. As an obvious example, there is no lawyer at the firm who would not have an irreconcilable conflict representing the client-entity with respect to determining the appropriate compensation for the firm. On the other hand, for example, "a lawyer's strong political beliefs may disqualify the lawyer from representing a client, but the firm should not be disqualified if the lawyer's beliefs will not adversely affect the representation by others in the firm."[37]

If a lawyer for an entity has a personal conflict or is otherwise uncomfortable assuming a position on the board, then he must "just say no." However, where an entity is pressuring its lawyer to accept a position on its board, she may be able to mollify the client by agreeing to serve as a director and recommending that a different firm lawyer represent the entity-client going forward.

Conclusion

A lawyer may simultaneously serve as counsel and as a director for an entity as long as, while a lawyer-director, she takes every reasonable step to ensure that the client-entity appreciates the distinction between her duties as counsel and her duties as corporate director and declines any representation of the entity, or recuses herself from further representation of the entity, if a conflict is reasonably foreseeable or arises between two or more of: (1) the lawyer's duties to the entity as its counsel; (2) the lawyer's fiduciary duties to the entity as a director; and (3) the lawyer's personal self-interest inherent in simultaneously serving in both roles. The lawyer-director must engage in full and frank discussions with the entity-client of all material risks inherent in the lawyer serving in such a dual role and must obtain informed consent thereto.

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1.This Opinion does not apply to lawyers who serve on the boards of entities for whom they do not also serve as counsel. *See, e.g.,* Harris, Micalyn S., and Karen L. Valihura. *Outside Counsel as Director: The Pros and Potential Pitfalls of Dual Service* (Business Lawyer, vol. 53, no. 2, Feb. 1998, pp. 479-506.)
2.*See, e.g.,* Restatement (Third) of the Law Governing Lawyers, § 135, comment d (2000).
3.Potter Stewart, *Professional Ethics for the Business Lawyer: The Morals of the Market Place*, 31 Bus. Law. 463, 464 (1975); see *The Lawyer as Director of a Client*, 57 Bus. Law. 387, 395-96 (2001). Lawyer-directors of nonprofit entities may also encounter potential issues, some of which are unique to nonprofits. For instance, some state statutes limit liability for uncompensated directors and officers of nonprofit organizations when they are acting in their capacity as directors and officers.
4.Lawyers provide advice on law and legal strategy to an entity client but do not make commercial or other business decisions on the ultimate objectives of the client. Such decisions are made by the entity, usually acting through its directors. *See* Rule 1.2. A lawyer who serves in both roles runs the risk of confusing and blurring these important distinctions.

5.A lawyer-director may have a conflict of interest in undertaking to provide legal advice to an entity-client regarding a challenge to the legality of actions in which he or she participated as a director. *See* generally Rule 1.7, comment [4]: "[I]f the probity of a lawyer's own conduct in a transaction is in serious question, it may be difficult or impossible for the lawyer to give client detached advice." However, under certain circumstances where the lawyer concludes that the conflict is consentable, the lawyer-director may provide such legal advice after notifying the entity-client of the conflict and obtaining its informed consent. Rule 1.7(c).
6.Because of the broad scope of insider knowledge and industry information presumably known by a lawyer-director, she may be targeted and called as witnesses by those bringing lawsuits against the corporate client, creating a potential personal conflict. Moreover, Rule 3.7 (Lawyer as Witness) may preclude the lawyer-director from serving as trial counsel. As per Comment [1], "combining the roles of advocate and witness can prejudice the opposing party and can involve a conflict of interest between the lawyer and client."
7.In this regard, plaintiffs sometimes may aim at strategically disqualifying the lawyer-director and the lawyer-director's firm from representing the corporation.
8.*See* Rule 1.8(g)(1) and Comment [13] thereto.
Although the D.C. Rules of Professional Conduct do not require a lawyer to carry professional liability insurance, having such protection is a sound and highly recommended practice. However, under some malpractice insurance policies that exclude non-law-related liabilities, lawyer-directors are entitled to less coverage – or even possibly no coverage at all – for work they perform in that dual role, even if a significant portion of the work performed was legal. See, e.g., *Continental Cas. Co. v. Smith*, 243 F. Supp. 2d 576, 582 (E.D. La. 2003). As such, lawyer-directors should always check with their insurers to determine if such limitations apply to their coverage.
9.A lawyer-director may not solve all conflict problems by refraining from providing legal advice to the client-entity. For example, she may have a conflict imputable to other members of her firm pursuant to Rule 1.10, or she and/or other firm lawyers may have a personal conflict, as discussed *infra*.
To be clear, however, it is not the position of the Committee that a Rule 1.7 conflict necessarily arises where the lawyer-director limits herself to serving as director and a different firm lawyer serves as counsel to the entity. Even in the absence of a conflict, lawyers should be aware that some courts have disqualified lawyers in such circumstances.
10.Code of Professional Ethics for Certified Public Accountants, Rule 101.
11.*See* ABA Model Rule 1.7, Comment [35]. *See also* ABA Formal Opinion 98-410, pursuant to which:

> 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./p>

12.*See* Rule 1.13(a) (Organization as Client). There are circumstances when a lawyer may undertake to represent simultaneously and jointly both the entity and one of its constituents in the same matter, but that issue is beyond the scope of this Opinion. *See*, e.g., D.C. Legal Ethics Opinion 327 (2005) (Joint Representation: Confidentiality of Information Revisited).
13.*See, e.g., The Lawyer as Director of a Client* (The Business Lawyer, Nov. 2001, Vol. 57, No. 1, at 388); ABA Model Rule 1.7.
14.Rule 1.8(g). See also Comment [13]: "Agreements prospectively limiting a lawyer's liability for malpractice are prohibited because they are likely to undermine competent and diligent representation."
15.*See, e.g.,* ABA Formal Opinion 98-410.
16.A basic feature of the lawyer-client relationship, sometimes frustrating to lawyers, is that the client has the right to make foolish decisions. For example, a client might reject an attractive settlement offer that the lawyer believes is greater than a probable judgment were the case to be tried and the client to prevail spectacularly. *See, e.g.,* Rule 1.13, comment [3]: "When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful. Decisions concerning policy and operations, including the ones entailing serious risk, are not as such in the lawyer's province."

Of course, a lawyer has the ethical duty to counsel and advise the client against such foolish decisions but, at the end of the day, the client has the unfettered right to reject the lawyer's advice regarding the objectives of the representation.
17.*See* discussion on Rule 1.13, infra.
18.*See, e.g., Escott v. BarCharis Constr. Corp.,* 283 F. Sup. 647 (S.D.N.Y. 1968).
19.*See, e.g., Feit v. Leasco Data processing Equipment Corp.,* 332 F. Supp. 54, 578 (E.D. NY 1971):

> Inside directors with intimate knowledge of corporate affairs and of the particular transactions will be expected to make a more complete investigation and have more extensive knowledge of facts supporting or contradicting inclusions in the registration statements than outside directors . . . such stringent requirements of knowledge of corporate affairs [apply to] inside directors that one is led to the conclusion that liability will lie in practically all cases of misrepresentation.

20.When the substantive law is proscriptive and the D.C. Rules are permissive or silent on the matter, then the substantive law will control. On the other hand, when the D.C. Rules are proscriptive and the substantive law is permissive or silent, the Rules will control.
21.*See Blakely v. Lisac,* 357 F. Supp. 255, 266 (D. Ore. 1972) (holding a lawyer-director "liable both as a lawyer and as a director" for drafting a fraudulent prospectus under SEC Rule 10b-5, while not holding other directors similarly liable).

22.In the District of Columbia, this is colloquially referred to as the "report up, but not out" rule; that is, a lawyer for an entity has the duty to report such information up to the highest decision maker within the entity, but may generally not report "out" to regulators or others because of the duty to maintain client confidences and secrets. See discussion on the implications of Rule 1.6

(Confidentiality of Information) on a lawyer-director, *infra*. But see D.C. Rule 1.6 (d) (narrow exception to permit lawyers to "report out" – but only "to the extent reasonably necessary" – when the lawyer's services were or are being used to perpetrate an economic crime-fraud.)

23.Rule 1.4, Comment [2].

24.*See* discussion on Rule 1.6 implications, infra.

25.*See, e.g.,* ABA Formal Ethics Opinion 98 – 410, *Lawyer Serving as Director of Client Corporation* (1998).

26.Some courts have even gone so far as to hold that the attorney-client privilege for communications between a lawyer and the lawyer's corporate client dissolves entirely when the lawyer becomes a director for the entity. *See, e.g., Federal Savings & Loan Ins. Corp. v. Fielding,* 343 F.Supp. 537 at 546 (D. Nev. 1972) (When a lawyer "gets into bed together" with the entity by serving also as a director, the lawyer converts the relationship into strictly a business relationship, rendering all communications between the lawyer-director and the entity as "business communications" unprotected by the attorney-client privilege.)

27.There is hardly a courtroom in the land where litigants do not regularly seek to pierce assertions of attorney-client privilege by arguing that the lawyer provided business advice, which is discoverable, and not legal advice, which is not. The courts have employed a wide variety of tests to determine whether a lawyer-director's communications are privileged, and some have ruled that "when the lawyer becomes a director the privilege essentially evaporates" and that even lawyer-director's communications which consist only of legal advice may not be privileged. Other courts have held that even non-legal advice is privileged so long as the parties sought purely legal advice from the lawyer-director. *See* ABA Formal Ethics Opinion 980-410, citing *Corp, v. Fielding,* 343 F. Supp. 537, 546.

28.For a comprehensive discussion of Rule 5.7, *see* Singer, Saul Jay, *May A D.C. Lawyer Build A Deck* (Washington Lawyer, *Speaking of Ethics*, March 2016).

29.Rule 5.7, Comment [8].

31.*See generally* Rule 1.7 (Conflicts of Interest: General) and Rule 1.9 (Conflict of Interest: Former Client), respectively.

31.A lawyer who has a personal stake in the outcome of her legal advice may, for instance, be tempted to provide more cautious advice. Even a lawyer-director whose self-interest is wholly congruent with the interests of the entity may nevertheless have a personal conflict if her concern for her own personal interest in any way interferes with her concern for the client's interest.

32.*See also* Comment [11]: "The lawyer's own interests should not be permitted to have an adverse effect on representation of a client. For example, if the probity of a lawyer's own conduct in a transaction is in serious question, it may be difficult or impossible for the lawyer to give a client detached advice."

33.Informed consent "denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct." Rule 1.0(e) (Terminology).

34.This would apply to both a director who subsequently seeks to represent the entity as counsel, and counsel for the entity who wants to serve on its board.

35.A lawyer-director might undertake the requisite self-evaluation in good faith and subjectively conclude that she will be able to devote herself entirely to the client's interests and disregard any

interest that might pose a personal conflict of interest. However, whether a reasonable person in the lawyer's position could *objectively* come to that conclusion under the circumstances is an important question that must always be addressed in personal conflict situations.

36.Rule 1.10(a)(1) provides that:

> (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 or Rule 1.9, unless:
>
> > (1) the prohibition of the individual lawyer's representation is based on an interest of the lawyer described in Rule 1.7(b)(4) and that interest does not present a significant risk of adversely affecting the representation of the client by the remaining lawyers in the firm . . .

37.Rule 1.10, comment [7].

Formal Opinion 1998-410

PBA Ethics Committee Endorses ABA Guidance for Lawyers Serving on Client's Board of Directors (as printed in the March/April 2000 issue of the PBA's *Pennsylvania Lawyer* magazine)

The PBA Committee on Legal Ethics and Professional Responsibility has formally endorsed ABA Formal Ethics Opinion 98-410 (Feb. 27, 1998) as a thoughtful and detailed review of the ethical issues that confront a lawyer who serves on the board of directors of that lawyer's client. The committee commends to all Pennsylvania attorneys a review of the ABA opinion in its complete form.
Some of the highlights of this important statement are set forth below.

- The Rules of Professional Conduct do not prohibit a lawyer from serving as a director of a corporation while simultaneously serving as its legal counsel. However, there are ethical concerns that a lawyer occupying the dual role of director and legal counsel should consider.
- The lawyer should assure at the outset of the dual relationship that management and other board members understand the difference between the responsibilities of counsel and the responsibilities of a director.
- In some circumstances, matters discussed at board meetings with the lawyer (in the role of director) will not receive protection of the attorney/client privilege. The opinion reviews the lawyer/director's obligation to protect the privilege and discusses risks arising from dual-capacity service.
- Conflicts of interest may arise that require the lawyer to recuse himself or herself from service as a director or to decline representation of the corporation in a particular matter.

ABA Formal Opinion 98-410 notes that not every lawyer will confront the same ethical challenges while serving on a board of directors. The issues will vary depending on the nature of the legal services being provided by the lawyer and the nature of the client's business.

The clearest directive of this opinion is found in the suggestion that counsel discuss with the directors, before taking on both roles, the ethical and practical pitfalls that lie ahead. The opinion then describes the lawyer's obligation to use reasonable care to protect the corporation's attorney/client privilege. Additionally, the opinion makes suggestions for the proper analysis of these concerns and for ways to minimize risks to the privilege. Finally, the opinion identifies the lawyer-director's obligation to confront and resolve ethical issues that may arise while occupying dual roles of attorney and director.

This ABA formal opinion concludes with a series of normative suggestions, which should help avoid a disciplinary infraction. None of these are surprising in their content, but a review by both the affected attorney and the corporate client will serve a highly useful function. (Note: These suggestions include a statement that a lawyer should recuse herself as director from board and committee deliberations when the relationship of the corporation with the lawyer/firm is under consideration, such as issues of engagement, performance, payment or discharge.) Although some may maintain that the dual capacity of attorney and director should not be permitted, this remains a minority view. Unless the governing principles change, the ABA's Formal Opinion 98-410 will serve as the ethical guidepost for practitioners in the years ahead.

[The full text of this important opinion is available from the ABA Center for Professional Responsibility (Product Code 561-1100).]

The Ethical Landmines of Dual Service: *United States v. Holmes*

SABRINA ELLIOTT*

INTRODUCTION

The legal profession has long debated whether lawyers should be allowed to engage in dual service, or represent corporations and also serve on their boards of directors.[1] In ABA Formal Ethics Opinion 98-410 (Opinion 410) issued in 1998, the Formal Committee on Ethics and Professional Responsibility held that there is no prohibition against lawyers serving on the board of directors of a corporation that they, or their firm, represents.[2] Indeed, the *ABA Model Rules of Professional Conduct* ("*Model Rules*") allow for this dual service.[3] While Opinion 410 does include a cautionary comment that a lawyer must evaluate whether the responsibilities of the two roles might conflict, neither the opinion nor the *Model Rules* provide clear guidance for lawyers about how to handle such conflicts. While there are benefits to this dual service, including the ability of the attorney to offer more comprehensive legal advice, this practice still warrants concern because of its vast ethical implications. Nonetheless, it is still a widespread practice.[4] Robert Swaine of New York's Cravath, Swaine & Moore once notably stated that while "most of us would be greatly relieved if a canon of ethics were adopted forbidding a lawyer in substance to become his own client through

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1. *See, e.g.*, Micalyn S. Harris & Karen L. Valihura, *Outside Counsel as Director: The Pros and Potential Pitfalls of Dual Service*, 53 A.B.A. BUS. LAW. 480 (February 1998).

2. ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 98-410 (1998).

3. *See* MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. 35 (2018) [hereinafter MODEL RULES]:

> 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, 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 the 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.

4. *See* Craig C. Albert, *The Lawyer-Director: An Oxymoron*?, 9 GEO. J. LEGAL ETHICS 413, 415 (1996) ("Outside counsel serve as directors of more than one in six public companies in the United States.").

acting as a director or officer of a client . . . the practice is too widespread to permit any such expectation."[5] And yet, as former Supreme Court Justice Potter Stewart warned, "there are significant ethical issues implicated by such dual service's intertwining 'the function of the lawyer in giving professional counsel' and 'the function of corporate management . . . in the profit-making interests of its stockholders.'"[6] While the ABA has yet to, and likely will not, ban the practice, it has consistently skirted the issue of what to do when inevitable conflicts arise as a consequence of this dual service.[7] Some of these conflicts include privilege and confidentiality challenges, which can lead to potential conflicting duties owed to the corporation.

The debate surrounding dual service has recently been reinvigorated given a notable case in the media: *United States v. Holmes*.[8] Elizabeth Holmes founded and served as chairman of the board of directors of Theranos, a now defunct health technology company.[9] She was convicted of wire fraud and conspiracy, and her trial ended in January 2020 after nearly four months of testimony.[10] David Boies, prominent litigator, and chairman of his own law firm, both served on the board of Theranos and as the company's attorney.[11] At trial, Boies was called to testify, and Holmes argued that all communication between Boies and herself was privileged under the doctrine of attorney-client privilege.[12] This controversy reminded those in the legal profession of the vast attorney-client privilege issues that arise when a lawyer both represents a company, either private or public, and serves on its board of directors.

This Note will argue that the ABA needs to provide updated *practical* guidance on how lawyers should ethically navigate the attorney-client privilege and confidentiality challenges that emerge when serving as both legal counsel and as a

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5. Robert T. Swaine, *Impact of Big Business on the Profession: An Answer to Critics of the Modern Bar*, 35 A.B.A. J. 89, 170 (1949).

6. D.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 382 (2021) (citing Potter Stewart, *Professional Ethics for the Business Lawyer: The Morals of the Market Place*, 31 BUS. LAW. 463, 464 (1975)).

7. *See* Albert, *supra* note 4, at 425 ("When the American Bar Association (ABA) was reformulating the rules governing lawyer conduct in the late 1970s and early 1980s, 62 members of the bar debated whether the new rules should contain a provision prohibiting the dual role as an impermissible conflict of interest. Not surprisingly, the successive drafts of the *Model Rules of Professional Conduct* (*Model Rules*) paint a telling picture of pressure within the bar to bury the issue"); *see also* Martin Riger, *The Model Rules and Corporate Practice – New Ethics for a Competitive Era*, 17 CONN. L. REV. 729, 743 (1985).

8. United States v. Elizabeth A. Holmes, 18-CR-00258-EJD (N.D. Cal. 2022).

9. Theranos "was a private health care and life sciences company with the stated mission to revolutionize medical laboratory testing through allegedly innovative methods for drawing blood, testing blood, and interpreting the resulting patient data." Holmes was charged with two counts of conspiracy to commit wire fraud and nine counts of wire fraud. It is alleged that she "engaged in a multi-million-dollar scheme to defraud investors, and a separate scheme to defraud doctors and patients." *United States v. Elizabeth Holmes, et al.*, DEPT. OF JUSTICE, https://www.justice.gov/usao-ndca/us-v-elizabeth-holmes-et-al [https://perma.cc/ATJ7-LDXU].

10. *Id.*

11. Steven Davidoff Solomon, *David Boies's Dual Roles at Theranos Set Up Conflict*, N.Y. TIMES (Feb. 2, 2016), https://www.nytimes.com/2016/02/03/business/dealbook/david-boiess-dual-roles-at-theranos-set-up-conflict.html?ref=dealbook&r=0 [https://perma.cc/LZ7C-UBRK].

12. Order Granting Pl. ['s] Mot. to Determine that Def. Lacks Individual Privilege Interest in Disputed Doc. 1, ECF No. 812.

member of the board of directors for a corporation. Despite extensive scholarship and debate within the legal profession about the subject, the ABA's guidelines for handling such conflicts have remained unchanged for more than two decades. Given the changes in the legal profession, especially the increase in lawyers serving on boards[13] and the lack of distinction between business and legal advice,[14] the ABA should adopt reform that provides greater clarity and uniformity for lawyers. Part I of this Note discusses the background of dual service, including benefits and drawbacks of the practice. Part II explores the attorney-client privilege and duty of confidentiality issues that arise out of dual service in the case of potential illegal activity by corporate officers, as demonstrated in *United States v. Holmes*.[15] Finally, Part III considers Opinion 410 and why it is insufficient to guide lawyers who serve on boards, then considers other State Bar Opinions, including the D.C. Bar Ethics Opinion 382, which, as a local ethics opinion could provide a model for the ABA to adopt,[16] and finally, offers a call for reform.

I. BENEFITS AND DRAWBACKS OF DUAL SERVICE

A. THE ROLE OF A CORPORATION'S LAWYER VERSUS ITS BOARD OF DIRECTORS

To understand the nuances of dual service, the role of both the corporate attorney and the board of directors needs to be addressed. According to Model Rule 1.13, a lawyer for a corporation represents only the organization itself.[17] Since a corporation is a distinct legal entity, a lawyer who represents a corporation "owes his allegiance solely to that [legal] entity" and not to the corporation's officers,

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13. *See*, *e.g*., Lubomir P. Litov, Simone M. Sepe, & Charles K. Whitehead, *Lawyers and Fools: Lawyer-Directors in Public Corporations*, 102 GEO. L.J. 413, 415 (2014) ("The result has been an almost doubling in the percentage of public companies with lawyer-directors from 2000 to 2009. The percentage of public companies with lawyer-directors was 24.5% in 2000, up to 47.5% in 2005, and 43.9% in 2009.").

14. *See, e.g*., Wilton S. Sogg & Michael L. Solomon, *The Changing Role of the Attorney with Respect to the Corporation*, 35 CLEV. ST. L. REV. 147, 156 (1987); Albert, *supra* note 4, at 446 (stating "since legal and business advice may be indistinguishable in these settings"); Bethany Smith, *Sitting on vs. Sitting in on Your Client's Board of Directors*, 15 GEO. J. LEGAL ETHICS 597, 597 (2002) ("For instance, when a lawyer-director gives advice to the board, is he giving legal advice or business advice? How do you tell? These questions do not always have clear-cut answers, yet the distinction is important.").

15. While this Note will primarily focus on confidentiality and attorney-client privilege issues for lawyers-directors in the case of illegal activity of corporate officers, there are other scenarios in which this is a problem, several of which include a change in corporate control which can involve both mergers and hostile takeovers. *See* Kas v. Financial Gen. Bankshares, 796 F.2d 508, 510–11 (D.C. Cir. 1986) (court recognized a duty to disclose, in proxy materials for cash-out merger, a lawyer's conflicting roles as both counsel and director of the corporation). *See also* Stephen M. Zaloom, *Legal Status of the Lawyer-Director: Avoiding Ethical Misconduct,* 8 U. MIAMI BUS. L. REV. 229, 236 (2000) ("Certainly, all discussions with an attorney-director present should not benefit from privilege. The dilemma becomes much more problematic in complex business issues where legal issues are inherently implicated.").

16. D.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 382 (2021) ("The purpose of this Opinion is to create a roadmap for practitioners to navigate the ethical and practical issues of such dual service.").

17. MODEL RULES R. 1.13 ("A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.").

directors, or shareholders.[18] The attorney's duty is to the corporation itself.[19] In some cases, this results in a complete lack of disclosure to shareholders about potential violations of fiduciary duty, or even legal violations.[20] Thus, while the corporate attorney communicates with corporate officers and the board of directors representing an organization, these individuals are not the client in the eyes of the law. This is an especially crucial distinction for the doctrine of attorney-client privilege.[21] The attorney for a corporation only retains attorney-client privilege with the corporation as an entity, not the individual corporate officers or the board of directors.[22] The corporation itself owns the privilege and retains the right to waive it.[23]

The board of directors of a corporation has many responsibilities and ultimately retains the authority to manage the corporation.[24] Among other roles, the board "acts as monitoring agents, decision-making authorities, and participants in the strategic planning process."[25] Because of this vast authority, directors are subject to the fiduciary duties of care and loyalty, which include "the subsidiary duties of good faith, oversight, and disclosure."[26] As such, the role of a

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18. Miriam P. Hechler, *The Role of the Corporate Attorney Within the Takeover Context: Loyalties to Whom?,* 21 DEL. J. CORP. L. 943, 954-55 (1996); *see also* George D. Reycraft, *Conflicts of Interest and Effective Representation: The Dilemma of Corporate Counsel*, 39 HASTINGS L.J. 605, 609–10 (1988); Egan v. McNamara, 467 A.2d 733, 739 (D.C. App. 1983) (stating that the obligation of corporate attorney in drawing up a buy-sell agreement was to the corporation regardless of the impact on individual shareholders); Wayland v. Shore Lobster & Shrimp Co., 537 F. Supp. 1220, 1224 (S.D.N.Y. 1982) (finding no conflict of interest for general counsel as he represented the corporation, not individual shareholders); Bobbitt v. Victorian House, Inc., 545 F. Supp. 1124, 1126 (N.D. Il. 1982) (stating that representing a corporation does not mean also acting as attorney to individual directors or shareholders); Meehan v. Hopps, 144 Cal. App. 2d 284, 290 (1956) (finding the attorney for a corporation does not represent corporate officers personally).

19. *See* Hechler, *supra* note 18.

20. *Id.*

> It is clear that if the corporation's management intends to engage in illegal conduct, the attorney may appeal to the board, and if that fails, the attorney may resign from his position. However, if the board of directors wishes to engage in action that violates its fiduciary duties to shareholders, the attorney is at a loss to determine a proper course of action. Rule 1.13(b) allows him to appeal to the board, but Rule 1.13(c) seemingly does not give him enough latitude to resign, and Rule 1.6 may keep him from revealing the intended harm to shareholders.

21. ABA Formal Op. 98-410 at n. 10:

> 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. The privilege extends to communications of the type described between a lawyer and her corporate client.

22. STEPHEN GILLERS, REGULATION OF LAWYERS: PROBLEMS OF LAW AND ETHICS 36 (12th ed. 2020).

23. *In re* Grand Jury Subpoena: Under Seal, 415 F.3d 333, 335 (4th Cir. 2005).

24. *See* Susanna M. Kim, *Dual Identities and Dueling Obligations: Preserving Independence in Corporate Representation*, 68 TENN. L. REV. 179, 208 (2001).

25. *Id.* at 213.

26. *See* Peter A. Atkins, Marc S. Gerber & Edward B. Micheletti, *Directors' Fiduciary Duties: Back to Delaware Basics,* HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Mar. 10, 2020), https://corpgov.law.harvard.edu/2020/03/10/directors-fiduciary-duties-back-to-delaware-law-basics/ [https://perma.cc/ME75-9D2P].

corporation's attorney and members on its board of directors differ in a crucial way: a "director owes a duty of loyalty to shareholders and other corporate constituents, while a lawyer owes a duty of loyalty only to the corporation."[27] A Report prepared by the ABA Section of Litigation's Task Force noted the "inherent conflict that often exists between a corporation's attorney and a corporation's board of directors."[28] A director is required to "'exercise an unbiased judgment in the management of a corporation's affairs . . . in the honest belief that the action taken is in the corporation's best interests,' while an attorney may make more 'conservative assessment[s] of the legal risks involved and thus [will] oppose corporate action that is otherwise perfectly warranted for legitimate business reasons.'"[29] While these duties might not always diverge, there are a few situations that commonly cause these two roles to be at odds, one of which will be discussed in Part II of this note.

B. BENEFITS OF DUAL SERVICE

Proponents of dual service offer many reasons why the practice should not only be permissible but also encouraged as it is beneficial to both the corporation as a client and the attorney.[30] One dominant benefit to both parties is that lawyers serving on a board of directors gain insight "into the 'ins-and-outs' of the client's business, enabling the attorney-director and his or her law firm to render more meaningful legal advice."[31] Further, attorneys will naturally point out legal issues in a proposed course of action before they even become legal issues, which can help directors make better strategic decisions.[32] Lawyers also bring a specific set of analytical skills, like their ability to inquire and critique proposed plans, that many corporate directors find useful in guiding the board.[33] Finally, dual service often results from a close relationship between a corporation and its lawyer; thus,

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27. Smith, *supra* note 14, at 601 (citing Zaloom, *supra* note 15, at 232).

28. Patrick W. Straub, *ABA Task Force Misses the Mark: Attorneys Should Not Be Discouraged from Serving on Their Corporate Clients' Board of Directors*, 25 DEL. J. CORP. L. 261, 264 (2000).

29. *Id.* at 264 (citing Peter B. Nagel, *Ethical Dilemmas of the Volunteer Lawyer/Nonprofit Director*, 23 THE COLORADO LAWYER 2735, 2736 (1994)).

30. *See* Litov, *supra* note 13 ("A lawyer-director increases firm value by 9.5%, and when the lawyer-director is also a company executive, the firm's value increases by 10.2%.").

31. Albert, *supra* note 4, at 416; *see also* Sogg & Solomon, *supra* note 14, at 153 (providing an overview of the dilemmas that face attorney-directors).

32. However, the attorney-director needs to be careful when offering legal, as opposed to business, advice in a board meeting, as the notes of such meetings are often discoverable in litigation and not covered under attorney-client privilege. *See* D.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 382. The distinction between "legal advice" and "business advice" will be discussed in Part II of this note.

33. Albert, *supra* note 4, at 417 (citing Carolyn T. Thurston, *Corporate Counsel on the Board of Directors*, 10 CUMB. L. REV. 791, 795 (1980)) (arguing that attorneys should serve their clients solely as counsel due to the ethical dilemmas associated with the dual role of lawyer-director).

this close relationship is both maintained and strengthened when a lawyer assumes a role on the board.[34]

C. DRAWBACKS OF DUAL SERVICE

Of course, there are strong opponents to dual service, who argue that a *per se* rule banning such practice is necessary to protect the independent judgment of corporate attorneys.[35] First, dual service might result in a threat to the independence of the individual as both an attorney and a director.[36] Recent developments in corporate governance emphasize the importance of independent directors on a board, especially to limit conflicts of interest and maintain strong oversight over the actions of corporate officers.[37] An attorney-director would not be considered an independent director.[38]

Further, since conflicts of interest are inevitable in dual service, the corporation could lose their most trusted legal advisor at critical points if the "lawyer-director is disqualified from representing the corporation in a given matter or has to recuse himself from participating in debate in the boardroom due to conflict of interest."[39] And, finally, perhaps the strongest argument against dual service is the threat to attorney-client privilege and confidentiality. Opinion 410 set out a general rule for attorney-directors to follow: "*legal* advice is protected by the attorney-client privilege and Rule 1.6, but *business-related advice* is not always protected and is potentially discoverable in litigation."[40] However, the distinction between legal advice and business advice is rarely clear-cut.[41] Many courts have held that, because attorney-directors owe fiduciary duties to the shareholders,

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34. Straub, *supra* note 28, at 263 (citing Robert P. Cummins & Megyn M. Kelly, *The Conflicting Roles of Lawyer as Director*, 23 LITIG. 48, 48 (1996)) ("The dual role apparently provides substantial benefits because it: (1) strengthen[s] the firm's ties to the client; (2) keep[s] the firm better informed of the client's business affairs; (3) improve[s] [the attorney's] credibility with the client; (4) result[s] in prestige for [the attorney] and his firm; and (5) assists [the attorney] in developing corporate contacts outside [of the corporation for which he or she serves as a director], which will likely generate business for his firm.").

35. *See, e.g.*, Albert, *supra* note 4, at 421.

36. *See, e.g.*, Kim, *supra* note 24, at 227–29 ("The detrimental effects on the independence of lawyer-directors prevent them from effectively fulfilling their decision-making role as board members.").

37. *See id.*

38. *Id.* at 214.

> Individuals who are executive officers or full-time employees of the corporation, such as the general counsel, would not be considered independent for purposes of board membership. Individuals outside the corporation who have material or ongoing business or professional relationships with the corporation or its management usually are not considered to be independent either. Thus, if the corporation's outside lawyers or investment bankers were to serve on the board, they might not be treated as independent directors because of their ongoing professional relationships with the corporation and its management. These individuals presumably have the same incentives as inside directors to conform to the wishes of the CEO who ultimately retains their services, and therefore they cannot be considered truly independent.

39. Smith, *supra* note 14, at 607.

40. D.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 382; *see, e.g.*, ABA Formal Ethics Opinion 98-410 at 5–6.

41. *See* Straub, *supra* note 28, at 267 ("this vague, often theoretical distinction, parties to litigation have frequently seen documents and conversations unexpectedly admitted into evidence.").

there "would be no privilege as to certain communications between the lawyer's firm and the corporation."[42] Further, as a director, the attorney-director might be required to disclose certain material to third parties, which may inadvertently waive the privilege.[43] The issue of confidentiality and attorney-client privilege will be discussed further in Part II.

II. DUAL SERVICE

A. THE DUTY OF CONFIDENTIALITY AND ATTORNEY-CLIENT PRIVILEGE

The lawyer's duty of confidentiality and the right to attorney-client privilege are two important pillars of the justice system, even for corporate clients. While all privileged information is inherently confidential, not all confidential information is privileged.[44] Only communications between a lawyer and a client are privileged, while a lawyer's confidentiality applies more generally to information relating to the representation of a client.[45]

The duty of confidentiality is outlined in Model Rule 1.6(a).[46] There are several exceptions to the duty of confidentiality, several of which are outlined in Rules 1.6(b),[47] 1.13(c),[48] and 3.3(c).[49] Some of these exceptions include self-defense and legal claims, waiver, or consent (which can be either express or implied), and exceptions for crimes and frauds and to prevent death and bodily harm.[50] In the case of a corporate client, Rule 1.13(c) establishes when an attorney can break confidentiality.[51] The rule related to exceptions for corporate clients will be discussed in greater detail in Section B.

The right to attorney-client privilege is an important common law evidentiary privilege. The common law elements of attorney-client privilege are as follows: "(1) There must be a communication (2) between counsel and client (3) in confidence (4) for the purpose of seeking, obtaining or providing legal assistance to

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42. C. Evan Stewart, *Ethical Issue for Business Lawyers: Lawyers-Directors: Just a Bad Idea*, 13 N.Y. BUS. L. J. 1, 31 (2009). *See id*. at 32 n. 5 ("AOC Ltd. Partnership v. Horsham Corp., 1992 Del. Ch. LEXIS (Del. Ch. 1992); Deutsch v. Logan, 580 A.2d 100 (Del. Ch.1990); Securities and Exchange Commission v. Gulf & Western Ind., Inc., 518 F. Supp. 675 (D.D.C. 1981); Valente v. PepsiCo, Inc., 68 F.R.D. 361 (D. Del. 1975); U. S. v. Vehicular Parking Ltd., 52 F. Supp. 749 (D. Del. 1949). Some of the issues inherent in this area are highlighted by the ongoing criminal and civil litigations involving AIG. In one manifestation, two former senior AIG officers and directors under indictment (who also have civil disputes with their former company) were allowed by the Appellate Division, First Department, to inspect privileged legal memoranda that were prepared for AIG during their tenure on the board of directors.").

43. Straub, *supra* note 28, at 268 ("it is clear that every time an attorney concurrently serves as a director of a corporate client, the attorney-client privilege is put in jeopardy").

44. Gillers, *supra* note 22, at 32.

45. *Id*. at 31–32.

46. *Id*. at 32.

47. MODEL RULES R. 1.6(b).

48. MODEL RULES R. 1.13(c).

49. MODEL RULES R. 3.3(c).

50. Gillers, *supra* note 22, at 43–48.

51. MODEL RULES R. 1.13(c).

the client."[52] In the context of a corporation as a client, the privilege belongs to the company and "protects communications between the company's constituents and its inside and outside counsel."[53] Although there are debates surrounding the justifications of privilege in the context of corporate clients,[54] it remains an important right in our legal system. In *Upjohn Co. v. United States*, the Supreme Court declared that the purpose of the privilege is "to encourage full and frank communication between attorneys and their clients, and thereby promote broader public interests in the observance of law and administration of justice."[55] In the corporate context specifically, attorney-client privilege is important as it incentivizes clients to fully disclose all actions to their attorney, thereby improving the sound legal advice that corporate attorneys can offer their clients.

There are few exceptions to attorney-client privilege. Privilege can be waived through consent or waiver, either explicitly or implicitly.[56] Waiver of privilege can include a client's disclosure of all or part of a communication to a third party.[57] This is an especially important consideration in the context of a corporation, as the corporation owns the privilege and the right to waive it. Thus, any corporate constituent, including a director, can waive privilege by sharing information with a third party. Another exception to privilege is the crime-fraud exception: "Communications between a client and counsel are not privileged when the client has consulted the lawyer in order to further a crime or fraud, regardless of whether the crime or fraud is accomplished and even though the lawyer is unaware of the client's purpose (as we must presume) and has done nothing to advance it."[58] Applying this exception can be difficult. Courts have generally applied a lower burden of proof to invoke the crime-fraud exception and ultimately, it is the Judge's determination whether the crime-fraud exception to the privilege is present.[59]

As mentioned in Part I.C. of this Note, dual service poses a serious risk to confidentiality and attorney-client privilege. While the ABA has previously instructed attorney-directors to distinguish between legal advice and business advice, it is often "unclear whether communications with the lawyer-director were made while he was acting in his capacity as a lawyer."[60] Only the communications with the attorney-director in their official capacity as a lawyer are

52. Edward B. Micheletti, Sonia K. Nijjar, & Patrick G. Rideout, *Just Between You and* Us, SKADDEN, ARPS, SLATE, MEAGHER, & FLOM, (Apr. 13, 2021), https://www.skadden.com/insights/publications/2021/04/the-informed-board/just-between-you-and-us [https://perma.cc/7GSB-RVCA].

53. Gillers, *supra* note 22, at 37.

54. *See, e.g.*, Elizabeth G. Thornburg, *Sanctifying Secrecy: The Mythology of the Corporate Attorney-Client Privilege*, 69 NOTRE DAME L. REV. 157, 158, 162 (1993).

55. Upjohn Co. v. United States, 449 U.S. 383, 389 (1981).

56. Gillers, *supra* note 22, at 44.

57. *Id.*

58. *Id.* at 45.

59. *Id.* at 47.

60. *See* Albert, *supra* note 4, at 446.

privileged. Conversely, because directors owe fiduciary duties to shareholders, "there is no privilege as to certain communications between the lawyer, his firm, and the corporation."[61] Thus, dual service results in "confusion. . .regarding which hat the lawyer–director is wearing; under which circumstances, in his role as lawyer, he is obligated to protect certain private information; and when, in his role as director, he is required to make disclosures."[62] As D.C. Bar Ethics Opinion 382 notes, "some courts have even gone so far as to hold that the attorney-client privilege for communications between a lawyer and the lawyer's corporate client dissolves entirely when the lawyer becomes a director for the entity."[63]

The potential loss of confidentiality attorney-client privilege is extreme, and yet the ABA has provided no practical guidance on how to handle such issues. The following section will evaluate the ethical issues related to confidentiality, attorney-client privilege, and dual service in the case of illegal activity from a corporate officer, as illustrated by *United States v. Holmes*.

B. CORPORATE FRAUD: THE DUTY OF LAWYERS AND THE DUTY OF DIRECTORS

Ordinarily, when an attorney's client is a corporation and constituents of that corporation make decisions for it, the decisions "must be accepted by the lawyer even if their utility or prudence is doubtful."[64] In the case of potential fraud by an officer, Rule 1.13(b) dictates how a lawyer can handle information that she "perceives to be 'a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization.'"[65] An attorney's course of actions generally depends on the severity of the officer's conduct, but her choices include asking the officer to reconsider, disclosing the matter to a higher authority within the organization—often the board—or, in extreme cases, withdrawing from representation.[66] Attorneys are directed to act "as is reasonably necessary in the best interest of the organization."[67]

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61. Evan Stewart, *USA v. Holmes: Why Lawyer-Directors Are a Bad Idea*, N.Y. STATE BAR ASS'N (Oct. 5, 2021), https://nysba.org/usa-v-holmes-why-lawyer-directors-are-a-bad-idea/ [https://perma.cc/79UD-RXJN] [hereinafter *Why Lawyer-Directors Are a Bad Idea*].

62. D.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 382.

63. D.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 382 (citing Fed. Sav. & Loan Ins. Corp. v. Fielding, 343 F. Supp. 537, 546 (D. Nev. 1972)) ("When a lawyer 'gets into bed together' with the entity by serving also as a director, the lawyer converts the relationship into strictly a business relationship, rendering all communications between the lawyer-director and the entity as 'business communications' unprotected by the attorney-client privilege.").

64. MODEL RULES R. 1.13 cmt 3.

65. Hechler, *supra* note 18, at 956.

66. *Id.*

67. MODEL RULES R. 1.13.

The duty of a director in the case of fraud might be different. Directors of corporation have a fiduciary duty to shareholders. As previously mentioned, this fiduciary duty includes a duty of care and oversight.[68] Thus, when "a red flag or warning sign appears, this duty of care requires reasonable investigation and diligence."[69] The directors owe this duty to the shareholders, and when "directors have actual knowledge of illegal or improper conduct or have knowledge of facts that should put the director on notice of such conduct, the directors must take good faith steps to remedy the problem."[70] So, "[i]f a non-lawyer corporate director learns of corporate conduct amounting to fraud . . . the director would have a wide range of options including, of course, informing the victim or the court that the fraud had occurred."[71] And, while an attorney is able to withdraw from representation in the case of managerial fraud, a director could be held personally liable for failing to rectify the conduct.

While the best course of action as either an attorney or a director separately might overlap, they have the potential to differ because of the contrasting interests at play with the varying corporate constituents. In the case of fraud by management "the interests of management directly conflict with the interests of the shareholders, limited partners, or other investors in the entity."[72] And, during litigation, communication that might have been privileged will likely be revealed in testimony if there was an attorney-director. Specifically, "[b]ecause 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."[73] This is just one example of the type of conflict that can arise out of dual service.

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68. Jeremy S. Piccini, *Director Liability, the Duty of Oversight, and the Need to Investigate*, AMERICAN BAR ASSOCIATION, Apr. 30, 2011.

> In reaction to such corporate scandals and regulatory actions, corporate boards are being held accountable for the failure to adequately oversee an institution's compliance function. For background purposes, a corporate board of directors is primarily responsible for overseeing the company, and in exercising these responsibilities, directors are charged with the fiduciary duties of care and loyalty. The duty of care mandates that a director act in good faith and use the degree of care that an ordinary person would exercise in a similar situation. The business judgment rule protects directors' decisions as long as the decision is informed, made in good faith, and with the honest belief that the action taken is in the company's best interest.

69. *Id.*

70. *Id. See* Stone v. Ritter, 911 A.2d 362, 365 (Del. 2006) (affirming the oversight standard of *In re Caremark* and emphasizing that directors must exercise "good faith" in dealing with potential or actual violations of the law or corporate policy).

71. § 3:32. Ethical limitations on the attorney as director, 1 Corporate Counsel Guidelines § 3:32 (2020).

72. Reycraft, *supra* note 18.

73. ABA Formal Op. 98-410 at 5. There are also situations in which 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." ABA Formal Op. 98-410 at 7.

C. AN ILLUSTRATIVE CASE: *UNITED STATES v. HOLMES*

The case of Theranos is a contemporary example that represents the dilemmas previously outlined. Theranos, a Silicon Valley-based company, became infamous when an investigative journalist uncovered that the company was lying to investors about what its blood-testing machine could do.[74] While the company itself settled with investors, lab regulators, and the Securities and Exchange Commission, Elizabeth Holmes, the former founder and CEO of Theranos, faced trial for eleven counts of fraud. The *Holmes* trial has uncovered several untruths told to investors,[75] and on January 3rd, 2022, Holmes was convicted on four counts of fraud.[76] David Boies was both an attorney for Theranos and served on its Board of Directors.[77] Many legal scholars have all pondered the same question: what hat was he wearing when he gave certain advice and how did it affect his legal advice?[78] The answer is important, especially when it comes to what communications, if any, were privileged in the *Holmes* case.[79]

In the case of Theranos, it is unclear if, or what, Boies knew about Holmes' fraud during the course of his representation.[80] But, his position as a director made it likely that much of the communication between himself and Holmes would be discoverable during litigation as he might not have been acting in his capacity as an attorney in certain situations. As he told *The New York Times*, he advised Holmes to get an independent verification of Theranos' technology after

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74. *See* John Carreyrou, *Hot Startup Theranos Has Struggled with Its Blood-Test Technology*, WALL ST. J. (Oct. 16, 2015), https://www.wsj.com/articles/theranos-has-struggled-with-blood-tests-1444881901 [https://perma.cc/GA8Y-ETFJ].

75. Heather Somerville, *Prosecutors in Elizabeth Holmes Trial Revealed Untruths, but Did They Prove Intent?*, WALL ST. J. (Nov. 21, 2021), https://www.wsj.com/articles/prosecutors-in-elizabeth-holmes-trial-revealed-untruths-but-did-they-prove-intent-11637499600 [https://perma.cc/K78T-LC83]. Among the evidence shown at trial was a forged document that indicated to investors that Pfizer, a large pharmaceutical company, supported the start-up and the technology.

76. Sara Randazzo, Heather Somerville, & Christopher Weaver, *The Elizabeth Holmes Verdict: Theranos Founder is Guilty of Four of 11 Charges in Fraud Trial,* WALL ST. J. (Jan. 3, 2022), https://www.wsj.com/articles/the-elizabeth-holmes-verdict-theranos-founder-is-guilty-on-four-of-11-charges-in-fraud-trial-11641255705?mod=hp_lead_pos7 [https://perma.cc/P4QA-2YZ5].

77. Solomon, *supra* note 11 ("Mr. Boies is taking on two different roles at Theranos. A lawyer represents a client—here Theranos—while a director, even at a privately held company like Theranos, represents the company's investors.").

78. Alaina Lancaster, *What Other Firms Can Learn From Boies Schiller's Role in the Elizabeth Holmes Saga* (Aug. 27, 2021), https://www.law.com/therecorder/2021/08/27/what-other-firms-can-learn-from-boies-schillers-role-in-the-elizabeth-holmes-saga/ [https://perma.cc/2ZBW-EYRA] ("It doesn't mean that a lawyer who is on the board can never have confidential, privileged communications, but it just makes it more complicated.").

79. Aside from confidentiality and attorney-client privilege issues, there are many other ethical issues related to the dual service of Boies, including his lack of independence as a director. *See* Solomon, *supra* note 11 ("Governance matters most in crisis times, and Theranos lacks it, to the chagrin of its investors.").

80. Model Rule 1.2(d) states that a lawyer cannot counsel clients to take actions that the lawyer knows are criminal or fraudulent. MODEL RULE 1.2(d). However, as Model Rule Comment 9 notes, the fact "that a client uses advice in a course of action that is criminal or fraudulent of itself [does not] make a lawyer party to the course of action." MODEL RULE 1.2 cmt 9.

The Wall Street Journal published their first article claiming the entire company was a sham.[81] While Holmes followed this advice, she began relying on outside lawyers and fired Theranos' general counsel, a former Boies Schiller attorney.[82] Boies claims that at this stage of their relationship, he wanted to resign as a director.[83] However, he was dissuaded from doing so as both fellow directors and his own outside counsel warned him that "he couldn't resign in a way that might damage shareholders."[84] Nonetheless, Boies ended his representation of Theranos after Holmes "made an overly optimistic presentation to shareholders without consulting Mr. Boies" in August 2016.[85] Now, the jury is in: Holmes was found guilty of three counts of wire fraud and one count of conspiracy to commit wire fraud by lying to investors to raise money for Theranos.[86]

After he withdrew from representation, Boies continued to be a director.[87] Since Theranos was a former client, Boies still had certain ethical obligations as an attorney related to confidentiality and attorney-client privilege. However, for those six months, he solely served as a director. Boies gave up his seat on the board in February 2017.[88] Throughout the tumultuous relationship between Holmes and Boies, his role as attorney-director and the conflict of interest may have been the "impetus for Boies's aggressive and distasteful defense of the company."[89] Often known as a lawyer with a propensity for bending the rules, some in the legal community have critiqued Boies throughout his representation of Theranos, commenting that "[h]e worked to intimidate whistleblowers, running up their legal bills and threatening litigation, and acted in a manner that Wall Street Journal reporter John Carreyrou, who exposed both Theranos and Boies, described as 'thuggish.'"[90] While nothing has been proven to indicate that Boies committed a disbarring offense, legal observers have noted that Boies represented Theranos in ways that helped "prolong their misdeeds."[91] The ethical concerns are clear: if Boies knew about the fraud, did he violate his fiduciary duty as a

81. James B. Stewart, *David Boies Pleads Not Guilty,* N.Y. TIMES (Sept. 21, 2018), https://www.nytimes.com/2018/09/21/business/david-boies-pleads-not-guilty.html [https://perma.cc/86WN-D7W6] [hereinafter *David Boies Pleads Not Guilty*].

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id.*

86. Erin Griffith & Erin Woo, *Elizabeth Holmes is found guilty of four counts of fraud*, N.Y. TIMES (Jan. 3, 2022), https://www.nytimes.com/2022/01/03/technology/elizabeth-holmes-guilty.html [https://perma.cc/V5MQ-7VCY].

87. The six months that Boies remained on the board, despite having fired Theranos as a client, also raises questions about his ability to serve as an independent director.

88. Stewart, *David Boies Pleads Not Guilty*, *supra* note 81.

89. Scott Alan Burroughs, *David Boies's Fall from Grace,* ABOVE THE LAW (Sept. 26, 2018), https://abovethelaw.com/2018/09/david-boiess-fall-from-grace/l [https://perma.cc/Q2YL-9ZWN].

90. *Id. See generally* JOHN CARREYROU, BAD BLOOD: SECRETS AND LIES IN A SILICON VALLEY STARTUP (2018).

91. Stewart, *Why Lawyer-Directors Are a Bad Idea*, *supra* note 61.

director by staying quiet? According to the ABA *Model Rules*, he did everything by the book.[92]

In Boies' defense of his fierce representation as attorney for Theranos, he points to an attorney's duty of loyalty to their client: "A lawyer is duty- and honor-bound to represent a client effectively and aggressively, within the bounds of the system itself. And once a lawyer takes on a client, you do not have the right to abandon that client under fire, except in extraordinary circumstances."[93] This statement emphasizes the loyalty that an attorney owes a client, but it also exposes some of the ethical concerns of an attorney-director: can the duty to the shareholders always co-exist with the zealous representation of a corporate client? *The New York Times* aptly notes that this "added another level of ethical complexity. As a board member, Mr. Boies assumed a fiduciary duty to shareholders. Now he was obliged to act in the best interest of two different parties: investors and company management. What if one—i.e., Ms. Holmes—acted in a way that harmed the other?"[94] In his capacity as an attorney, Boies had no ethical obligation to report Holmes' fraud, if he knew about it, to anyone outside of the company. However, in his capacity as a director, the answer is not as clear. He might have had a duty to disclose her actions to other directors to satisfy the duty of oversight. This duty of oversight includes an obligation to act in good faith and, when necessary, investigate a potential problem further.[95]

In Holmes' trial, there was another layer of privilege issues, as Holmes tried to argue that Boies was her personal attorney, and therefore all communication between her and Boies was privileged. However, when the government subpoenaed certain files related to their relationship, the court ruled that, since Boies was Theranos' attorney and not Holmes', the documents were admissible at trial.[96] Even without that ruling, when the government presented information

92. Although this is not a case in which there was a public securities offering, note that "the lawyer may also have a duty to investigate a client before assisting in a securities offering. In such cases, the lawyer's failure to discover fraud or self-dealing has been held to be actionable if a reasonable investigation would have uncovered the fraud." Reycraft, *supra* note 18, at 610.

93. Stewart, *David Boies Pleads Not Guilty*, *supra* note 81.

94. *Id*.

95. *See* Piccini, *supra* note 68.

96. *See* Stewart, *Why Lawyer-Directors Are a Bad Idea*, *supra* note 61:

> The magistrate judge ruled that, out of the five *Graf* prongs, Holmes failed on the second, fourth, and fifth. The second prong is that Holmes could not demonstrate that she made it clear to Boies that she was seeking his legal advice as an individual rather than as the CEO of Theranos. Key to the magistrate judge's determination was the fact that there was no Holmes-Boies engagement letter. The fourth prong is that Holmes could not demonstrate that her communications with Boies were confidential because the 13 documents reflect communications "between Holmes or other senior Theranos employees, Theranos in-house attorneys, and [the Boies law firm]." And the fifth prong is that Holmes could not demonstrate that the communications "did not concern matters within. . . . the general affairs of the company." Based upon those determinations, and the fact that the entity now in charge of Theranos (the "Assignee") was waiving the corporate privilege, the documents were ruled admissible.

related to Boies and Holmes at the trial,[97] "a fair amount of the 'advice of a seasoned lawyer' was already fair game, and Boies was always going to be a factual witness based upon his director status."[98]

This complicated case highlights some of the ethical issues and questions that arise related to confidentiality and attorney-client privilege when an attorney is allowed to serve on the board of a corporation while serving as their outside counsel. Despite the clear conflicts, the ABA provides very little guidance for how to handle such a situation.

III. PUBLISHED ETHICS OPINIONS AND POTENTIAL SOLUTIONS

A. ABA FORMAL ETHICS OPINION 98-410

The most recent ABA Ethics Opinion to address the ethical dilemmas of an attorney-director was published in 1998.[99] This twelve-page opinion emphasized the precarious nature of dual service, especially the ABA's "concerns with protecting the confidentiality of client information, especially protecting the attorney-client privilege."[100] And yet, the opinion provides negligible practical advice for attorneys who opt to serve in both roles. The opinion emphasizes "full, free and frank discussions by the lawyer with the corporation's executives and the other board members" before the lawyer accepts dual service.[101] Specifically, the ABA recommends that in situations where 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."[102] Finally, Opinion 410 suggests the attorney provide a written memorandum explaining the difference between her role as a director and an attorney[103] and have another attorney present at meetings strictly related to legal matters.[104]

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97. *See* Order Granting Pl. ['s] Mot. to Determine that Def. Lacks Individual Privilege Interest in Disputed Doc. 2, ECF No. 812. ("In June 2020, the government served Holmes with its Exhibit List for trial, which included thirteen documents that Holmes claims implicate her attorney client privilege.").

98. Stewart, *Why Lawyer-Directors Are a Bad Idea*, *supra* note 61 (citing AOC *Ltd. Partnership v. Horsham Corp*., 1992 Del. Ch. LEXIS 110 (Del. Ch. 1992); *Deutsch v. Logan*, 580 A.2d 100 (Del. Ch. 1990); *S.E.C. v. Gulf* & Western Ind., Inc., 518 F. Supp. 675 (D.D.C. 1981); *Valente v. PepsiCo, Inc*., 68 F.R.D. 361 (D. Del. 1975); *United States v. Vehicular Parking Ltd*., 52 F. Supp. 749 (D. Del. 1949)).

99. ABA Formal Op. 98-410 at 4.

100. *Id*.

101. *Id*. (stating that "[w]hen 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").

102. *Id*. ("[T]he 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.").

103. *Id*. at 4-5 ("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.").

104. *Id*. at 6 ("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. . . When

Opinion 410 is criticized by many legal scholars.[105] While it provides cautionary warnings, "the mandated warnings are likely to be heavily discounted by the client who views the very generalized events alluded to in each of the preceeding warnings as unlikely to occur."[106] Further, while Opinion 410 has addressed what a law firm or attorney-director should do in some situations related to disclosure of confidential information,[107] it "provides no additional specificity regarding the conflicts that will cause the attorney to withdraw from either serving as the company's director or its lawyer"[108] and "does nothing to clarify the ambiguity of what constitutes a conflict or what is the appropriate response to a conflict of the director-lawyers' roles."[109] One of the most common conflicts, the potential loss of attorney-client privilege, is not mentioned in Opinion 410 at all, let alone does it provide a proper course of action. It simply advises the attorney to "exercise reasonable care to protect the corporation's confidential information and to confront and resolve conflicts of interest that arise."[110] This standard gives great weight to the attorney to determine whether dual service is appropriate and this "lenient self-policing leaves too much room for abuse."[111]

B. STATE ETHICS OPINIONS

There are several prominent state bar ethics opinions that address the precarious position of attorney-director, with the most recent released by the D.C. Bar Ethics Committee in August 2021.[112] Some of these opinions essentially mimic

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appropriate, the lawyer-director should have another member of her firm present at the meeting to provide the legal advice.").

105. *See, e.g.*, Smith, *supra* note 14, at 601.

> There are several flaws in Formal Opinion 98-410. First, it fails to address the concerns about the potential loss of professional judgment or the threat of liability for the lawyer-director and his firm. Second, the opinion advocates inviting another lawyer to the board meetings. This would be very costly to the client who will now have to pay two outside lawyers for attending the board meeting, instead of just one. Third, if the lawyer-director will be stepping down from either of his roles due to conflicts, this will pose a hardship on the client who now may be short staffed on the board. The loss of an attorney intimately familiar with a client's legal problem will be costly in both time and money. Finally, the opinion has been criticized because the standard proposed by the ABA is weak and leaves the decision to the attorney to determine whether his representation will be materially hindered. This lenient self-policing leaves too much room for abuse.

See also Reycraft, *supra* note 18, at 615 ("[T]here are no clear-cut guidelines for resolving many of the complex ethical dilemmas that arise for corporate counsel.").

106. James D. Cox, *The Paradoxical Corporate and Securities Law Implications of Counsel Serving on the Client's Board*, 80 WASH. U. L.Q. 541, 545 (2002).

107. ABA Formal Op. 98-410 at n.15 ("A law firm normally responds to auditors asserting . . . that its engagement has been limited to specific matters. . . 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.").

108. Cox, *supra* note 106, at 545.

109. *Id.*

110. ABA Formal Op. 98-410 at 1.

111. Smith, *supra* note 14, at 613; *see* Zaloom, *supra* note 15, at 238.

112. D.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 382.

Opinion 410 from 1998, while others, like D.C. Opinion 382, take Opinion 410's guidelines one step further. For example, New York mandates that "the lawyer must disclose to the client the risk of loss of the attorney-client privilege."[113] This Opinion is very similar to Opinion 410. The California Bar emphasizes an attorney's confidentiality duties and attorney-client privilege over the fiduciary duties of her position as a director.[114] It states that duty of confidentiality and attorney-client privilege "may prevent her from fulfilling her fiduciary obligations to Corporation,"[115] but provides inadequate guidance on what to do when the two conflict. Even though these two states are usually the first to deviate from the mold and adopt their own guidelines, both opinions essentially replicate ABA Opinion 98-410 and leave attorney-directors without guidance, further indicating the need for reform.

D.C. Opinion 382 adopts the recommendations of ABA Opinion 410, mentioning that there should be adequate warning about the differences between business and legal advice, and recommends hosting separate meetings for purely legal advice that other attorneys from the law firm should attend.[116] While the opinion still does not clearly delineate between business and legal advice, it does go one step further and provides more practical advice to attorney-directors. First, it states that when a lawyer is providing business advice along with legal advice, they will be subject to Model Rule 5.7, which explicitly states that lawyers are subject to the Rules of Professional Conduct if the law-related services (in this case, the business advice) is provided either "by the lawyer in circumstances that are not distinct from the lawyer's provision of legal services" or "if the lawyer fails to take reasonable measures to assure that a person obtaining the law-related services knows that the services are not legal services and that the protections of the client–lawyer relationship do not exist."[117] Additionally, D.C. Opinion 382 specifically suggests that "the lawyer-director might consider the crafting of meeting minutes so as to avoid revealing client confidential information in privileged discussions with entity counsel."[118] The recommendation about meeting minutes, even though a very minor update from 1998, demonstrates the kind of practical advice that should be coming from the ABA and other state bar associations.

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113. N.Y. Op. 589 at 2 (1988).

114. Cal. Formal Op. No. 1993-132 ("The attorney has a duty 'at every peril to himself or herself to preserve the secrets of his or her client . . . if Corporation is the attorney's client . . . her duties . . . would preclude the attorney's disclosure or misuse of such information received in the course of any of her activities on behalf of Corporation.").

115. 115. Cal. Formal Op. No. 1993-132.

116. 116. D.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 382.

117. 117. D.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 382.

118. D.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 382.

C. POTENTIAL REFORM: THE NEED FOR PRACTICAL AND SPECIFIC ABA GUIDELINES

The ABA has largely left this problem untouched since 1998—leaving state bar associations and law firms to solve the problem. However, as demonstrated, state bar opinions as recent as 2021 have yet to make significant progress in helping attorneys navigate the ethical dilemmas. And, while many large firms have policies on this issue, these policies scantly address the frequent problems that arise, like the loss of attorney-client privilege.[119]

There are significant benefits to dual service that make a *per se* rule undesirable. Moving forward, Model Rule 1.7, which governs conflicts of interest, and Comment 14 should be amended [120] to outline common conflicts that arise during practice, including illegal activity from corporate officers as demonstrated in *Holmes*, and to provide specific guidelines for attorney-directors to follow. Additionally, the ABA should provide some type of instruction related to what is considered "business" advice and what is considered "legal" advice. In particular, the ABA should consider including a list of what they consider purely legal advice, and state that anything not included within the list is designated as business advice. For situations where the two get too muddled to clearly delineate, like a case of criminal conduct by a corporate officer, the ABA should provide clear, feasible steps that the attorney-director should take when moving forward with representation. As this distinction is of the utmost importance for attorney-directors and a client's right to privilege, it is necessary that there be some uniformity among the legal profession to protect privileged information more adequately. Without such, the convoluted roles of attorney-directors will continue to cause ethical issues and result in the demise of many pillars of our justice system, including confidentiality and attorney-client privilege.

CONCLUSION

In a perfect world, a corporate attorney would be able to serve on the boards of directors of their corporate clients without conflict, especially because so many attorneys see directorships as a valuable accomplishment in their careers. But the ethical landmines of dual service are everywhere and "to the extent a lawyer-director's obligations as a director are inconsistent with his or her ethical obligations as a lawyer, the lawyer-director cannot maintain the independence that the legal profession demands."[121] Despite the inherent and frequent conflicts, the

119. Smith, *supra* note 14, at 614.
120. *Id*. at 618.
121. Albert, *supra* note 4, at 472.

ABA and state ethics opinions have provided very little, if any, practical advice for attorney-directors. *United States v. Holmes*, a timely case, has only highlighted the ethical dilemmas facing the attorney-director. As the practice becomes more widespread, the debate surrounding this dual service will only continue, making it all the more dire that the legal ethics community adopt revised and practical guidelines.

Opinion 589

3.18.1988

By Committee on Professional Ethics

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NEW YORK STATE BAR ASSOCIATION
Committee on Professional Ethics

Opinion #589 03/18/1988 (25-87)

Topic: Conflict of interest; lawyer serving as director of client organization
Digest: Not per se improper for lawyer to serve as director of client organization or as chair of board of directors; ethical constraints reviewed
Code: DR 1-102(A)(6), 2-103(A), 5-101(A), 5-102, 5-105(D); EC 5-1, 5-2, 5-9, 5-10

QUESTION

1. What are the ethical constraints upon a lawyer for a corporation or other organization who also serves as a member of its board?
2. Are there additional ethical considerations where the lawyer for the organization is also the chair of its board?

OPINION

Without endorsing the practice, which has received considerable attention and criticism, we conclude there is no per se rule of professional ethics that prohibits a lawyer for a corporation or other organization from also serving on its board of directors or trustees. In fact, a number of ethics opinions from various jurisdictions have established the ethical propriety of a lawyer serving as a director of a client organization. See, e.g., ABA Inf. C-431 (1961); Illinois Op. 483 (1975), Ill B.J. 136 (1975), indexed in Maru's Digest Ho. 8371 (1975); Maryland Op. 87-29 (1987), indexed in ABA/BNA Manual (Vol. III, No. 21, Nov. 11, 1987); N.Y City 611 (1942); North Carolina Op. 802 (1972), N.C.S. B. II-250 (1972), indexed in Maru's Digest No. 9553 (1975); Oregon Op. 461 (1981), indexed in ABA/BNA Manual 801:7107; Virginia Op. 453 (1983), indexed in ABA/BNA Manual 801:8809; Wisconsin Op. E-84-12 (1984), indexed in ABA/BNA Manual 801:9913. Nevertheless, the potential for compromise of a lawyer's independent professional judgment presented by such dual service has led many commentators to condemn the practice. See, e g, G. Wolfram, Modern Legal Ethics 738-40 (1986); Lorne, "The Corporate and Securities Adviser, the Public Interest, and Professional Ethics," 76 Mich. L. Rev. 423, 490-95 (1978); Gary, "Professional Responsibility in the Practice of Corporate Law -The Ethics of Bar Associations," 29 Rec. Ass'n Bar City of NY 443, 446 (1974).It is the view of this Committee that a lawyer representing an organization may also serve as one of its directors, provided the responsibilities of the two roles do not conflict. Thus,1. the lawyer may not take advantage of the directorship as a feeder for his or her legal practice;2. the lawyer must disclose to the client the risk of loss of the attorneyclient privilege and any other consequences of counsel's dual role; and3. in carrying out his or her role as counsel, the lawyer must exercise independent professional judgment free of compromising influences that arise in connection with service as a director.There is no question that the lawyer/director relationship raises a number of concerns under the Code of Professional Responsibility. An examination of these concerns, in turn, allows us to articulate guidelines by which a lawyer serving as a director of a client organization may govern his or her conduct.DR 2-103(A) of the Code prohibits solicitation of employment by a lawyer in violation of any statute or court rule. See also N. Y. Judiciary Law§ 479; In re Greene, 54 NY. 2d 118 (1981), cert denied, 455 U.S. 1035 (1982); In re Koffler, 51 NY 2d 140 (1980), cert. denied, 450 U.S. 1026 (1981); In re Alessi, 60 NY 2d 229 (1983); NY State 566 (1984); NY State 549 (1983). This provision prohibits a lawyer from taking advantage of his or her position as a director to procure professional employment for the lawyer or the lawyer's firm. See, e. g., N.Y. State 465 (1977); NY. State 206 (1971); ct. ABA Inf. G-431 (1961). This provision also must be interpreted to preclude a lawyer/director from participating in the decision-making process concerning the retention of the lawyer as the organization's legal

counsel. See NY City 611 (1942); Wisconsin Op. E-84-12 (1984), indexed in ABA! BNA Manual 801:9913.The Code expressly forbids a lawyer, absent client consent, from accepting employment if the lawyer's exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer's own financial, business, property, or personal interests. DR 5-101(A). An attorney has an ethical responsibility to exercise professional judgment solely for the benefit of the client and should not allow personal interests, other clients' interests, nor third persons' desires to dilute this loyalty. EG 5-1 In addition, EG 5-2 warns that a lawyer should not assume a position that would tend to make the lawyer's judgment less protective of the interests of the client.This general conflict of interest provision is also contained in the American Bar Association's Model Rules of Professional Conduct. The Model Rules have not been adopted in New York State. We believe, however, that the Comment to Rule 1.7 of the Model Rules accurately reflects the relevant concerns under the principles articulated in the Code of Professional Responsibility. That Comment notes the potential conflict that board service by an organization's lawyer entails: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, the lawyer should not serve as a director.These general conflict of interest principles coupled with the universal prohibition against fiduciary self-dealing would prohibit a lawyer/director from participating in any decision of the client that will or reasonably may affect the lawyer's own personal or financial interests as counsel See also, DR 1-102(A)(6); Business Corp. Law§ 713; Not-for-profit Corp. Law§ 715. In addition to such obvious situations, the lawyer serving on the client's board must be sensitive to more subtle influences that could impair his or her independent professional judgment.The risk that professional judgment may be improperly influenced by the lawyer/director's dual role will depend on such factors as the nature of the matter on which legal advice is sought, the financial remuneration paid to the director and the fees paid to the lawyer. It is clear, for example, that a lawyer who also serves as director would be disqualified as counsel in any controversy between the organization and its directors. Other situations, such as rendering legal advice to the client regarding a lawsuit involving the directors, or the personal liability of directors to the organization, likewise present a serious risk that professional judgment would be improperly influenced. Less obviously, if the directorship fees are financially significant to the lawyer, his or her professional judgment on behalf of the client reasonably may be affected. It is the duty of each lawyer to examine carefully the potential for conflict presented by different circumstances, and to disqualify himself or herself (and the lawyer's firm) as counsel wherever there exists a risk that professional judgment or loyalty may be compromised.Further ethical qualifications upon a lawyer sitting on a client's board are found in DR5-102 which, with certain specified exceptions, requires a lawyer to withdraw as counsel when the lawyer becomes a potential witness in contemplated or pending litigation. See also EG 5-9, 5-10. It has also been held that the lawyer/director must fully disclose to the client the potential loss of the attorney-client privilege incident to the lawyer's involvement in the client's business decisions. See Illinois Op 483 (1975), Ill B.J. 136 (1975), indexed in Maru's Digest No. 8371 (1975); cf. C. Wolfram, Modern Legal Ethics 739-40 (1986).As to the second question, we do not believe that a different analysis should apply where the lawyer is serving as chair of the client's board of directors. See, e. g., ABA Inf. C-431 (1961) (lawyer may serve as chair of bank's board of directors). Because of the chair's more extensive involvement in decision-making concerning the management of the organization, however, it is possible if not, indeed, likely that the responsibilities of the two roles will conflict more frequently than in the case of a mere director. If that in fact occurs, and if the non-participation of the chair in such matters is seriously detrimental to the functioning of the board, then the lawyer should not serve as chair. Moreover, in that circumstance the mandate of DR 5-105(D) would also apply, namely that if a lawyer would be required to decline or to withdraw from service as a member or chair of the client's board, no partner or associate of that lawyer may accept that board position.

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ILLINOIS STATE BAR ASSOCIATION

THE BOTTOM LINE

The newsletter of the Illinois State Bar Association's Standing Committee on Law Office Management & Economics

Ethics considerations for Illinois attorneys serving on non-profit boards

By Dan Ebner, Prather Ebner LLP, Chicago, IL

Attorneys have insights that often make us attractive members of nonprofit boards. However, accepting a position as a nonprofit board member has risks because the role of a board member who happens to be an attorney can inadvertently slide into that of an attorney who represents the organization through its board. And even when a board member affirmatively chooses to also represent the organization, a host of ethics issues are present.

This article identifies the key ethics rules related to attorneys serving on nonprofit boards, discusses the different roles an attorney-board member can have, and analyzes conflicts issues in greater detail. Although it's beyond the scope of this article, you should also consider fiduciary duties imposed by state and federal law on your service on a not-for-profit board and how privilege relates to your service as a board member.

I. Relevant Provisions of the IRPC

While the Illinois Rules of Professional Conduct do not directly apply to an attorney who serves a nonprofit solely as a board member, they do directly apply to how that attorney's services as a board member may impact the attorney's clients, and they do apply to an attorney who also—intentionally or inadvertently—represents the nonprofit organization as an attorney. Consequently, they are the starting point for our discussion.

Continued on page 2

Law firm succession and exit strategies: Coming to terms with aging

By John W. Olmstead, MBA, Ph.D., CMC

Several years ago I was giving a presentation to an ALA (Association of Legal Administrators) Chapter and after the presentation an administrator came up to me and asked, "what kind of financial incentives can we put in place to encourage some of our senior attorneys to retire"? I responded by saying "help them identify some hobbies." While my comment was partially in jest, many attorneys, especially baby boomers, have invested so much into their careers and law practices they have not had either the desire or time to invest into other areas of interest. Their work has been their life often to the exclusion of family, friends, and other interests and pursuits. *These lawyers avoid thinking about aging and retirement like the plague.* Often their goal is to work forever which is a common goal expressed to me by senior lawyers. Six out of ten Baby Boom generation lawyers that I am working with on succession engagements tell me that they want to work as long as they possibly can. For some they would like to retire but they need the money and cannot afford to stop working. For others they enjoy their work, love what they do, and simply do not want to retire.

On the flipside, I have Generation X (adults born between 1961 and 1981) lawyers approaching in their 40s wanting to begin planning

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Ethics considerations for Illinois attorneys serving on non-profit boards

Continued from page 1

A. Rule 1.13: Organization as a Client

Rule 1.13(a) makes clear that an attorney "retained by an organization represents the organization acting through its duly authorized constituents." Consequently, when the lawyer also serves as a board member of the organization, the lawyer is one of the "duly authorized constituents" that the lawyer must work through to represent the organization. This dual role leads to an array of issues involving competence, independent judgment, confidentiality, and conflicts. A lawyer who is considering serving a nonprofit as a board member or as a board member and lawyer should carefully consider these issues.

B. Rule 1.1: Competence

Rule 1.1 requires a lawyer to provide "competent representation." Competence is an issue for lawyers serving on nonprofit boards because the board will often look to the board member for (free) guidance on a broad range of legal issues that may be outside of the lawyer's expertise even when the lawyer is only acting as a board member. Similarly, if the lawyer-director is also acting as legal counsel for the board, and is providing that service on a low-cost or *pro bono* basis, there will be pressure by the other board members for the attorney to offer low cost or free legal advice on issues that are outside the lawyer's competence. Consequently, a lawyer serving on a nonprofit board or providing low cost or free representation should be careful to always recommend the board hire outside counsel if a legal issue arises that is outside the lawyer's areas of competence.

C. Rule 2.1: Advisor

Rule 2.1 requires an attorney to "exercise independent professional judgment and render candid advice" when representing a client. When an attorney is both a board member and legal counsel for a nonprofit, the attorney should be careful to consider whether the attorney's ability to give "independent professional advice" on legal topics has been compromised by the attorney's role as a board member. For example, if the attorney, acting as counsel, is asked to give an opinion about the legality of a board decision, the independence of that opinion could be compromised if the attorney was a member of the board when the board decision was made.

D. Rule 1.6: Confidentiality of Information

Rule 1.6 relates to a lawyer's duty to keep client information confidential "unless the client gives informed consent" or "the disclosure is impliedly authorized in order to carry out the representation." Rule 1.6 does not apply to communications between the attorney and other board members if the attorney is acting as a board member. However, if the attorney is intentionally or unintentionally acting as legal counsel for the organization, then Rule 1.6 requires the attorney to keep communications related to that representation confidential.

E. Rule 1.7: Conflict of Interest: Current Clients

Rule 1.7 relates to conflicts of interest with current clients and prohibits a lawyer from representing a client if the representation "will be directly adverse to another client." I.R.P.C. 1.7(a)(1). In addition, Rule 1.7 prohibits a lawyer from representing a client if there is a "significant risk" the representation "will 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." *Id.* at 1.7(a)(2). Finally, Rule 1.7 permits a lawyer to represent two current clients with a conflict if the "lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client" and the client gives "informed consent" in writing. *Id.* at 1.7(b)(1), (4). However, two types of conflicts cannot be waived: representations "prohibited by law," and representations involving claims by clients against each other in litigation "or other proceeding before a tribunal." *Id.* at 1.7(b)(2)-(3).

For our purposes, the current conflict rule can be boiled down as follows:

- A lawyer cannot act adverse to a current client;
- A lawyer should be extremely careful about representing multiple clients who appear to be similarly situated because their interests may diverge;
- Many of these prohibitions can be overcome with informed consent; however, a lawyer should be cautious.

Additional commentary on Rule 1.7 as it relates to attorney service on a nonprofit board can be found in comment 35 to the Rule, the *Restatement (Third) of Law Governing Lawyers* § 31, ABA ethics opinions, ISBA Advisory Opinion No. 86-14.

II. What Role is the Attorney Acting In?

An attorney can serve a nonprofit organization in two ways: 1) as a member of the organization's board; and 2) as an attorney who represents the organization through the board. Because both roles may give rise to a conflict with current clients, an attorney taking either role should run a conflicts check and obtain law firm approval.

The general rule for determining the existence of an attorney-client relationship is whatever the client reasonably believed. *See Herbes v. Graham*, 180 Ill.App.3d 692, 699 (2nd Dist. 1989). So if the other board members reasonably believe they are receiving legal advice from an attorney-board member, a court will likely find the existence of an attorney-client relationship. Consequently, an attorney should document in a letter to the board what capacity the attorney will be providing services to the nonprofit organization. In addition, if the attorney is serving as counsel, the attorney should make clear that the client is the organization—not the individual board members. I.R.P.C. 1.13. And an attorney representing the organization should follow the usual procedures for obtaining a signed retention letter laying out the scope of the representation.

Because board members tend to lean on an attorney-board member for legal advice, an attorney who is only acting as a board member should periodically remind the other board members of this limited role. This reminder may be an annual letter to the board, comments in the minutes suggesting the board retain counsel, or comments in the minutes stating that advice on a topic reflects the attorney-board member's business judgment and is not legal advice.

Finally, an attorney-board member who also represents the organization should repeatedly make clear that the organization, and not the board members, are the client and that the attorney cannot provide legal advice to board members about their service on the board. The attorney may also want to make clear during board meetings whether

the particular advice being given is legal advice as an attorney or whether it is business advice as a board member.

III. Conflicts of Interest

A. Identifying the Source of the Potential Conflict

The nonprofit organization and its board members are not clients if an attorney only serves as a board member (being mindful of the need to make this clear to the organization and the other board members). If an attorney also represents the organization, then the organization, and not the individual board members, is the client and can be a source of a conflict. I.R.P.C. 1.13.

While the starting point for conflicts analysis is identifying the client, it's also important to consider if there are any personal interests of a lawyer that may create a conflict of interest under I.R.P.C. 1.7(a)(2). Thus, although the non-profit is not a client when the attorney is only acting as a board member, service on the board may still present a conflict with existing clients. And an attorney may have personal interests that create a conflict with the attorney's representation of the nonprofit – even if the attorney does not have other clients adverse to the nonprofit.

Although it isn't an ethics rule, the duty of loyalty should also be considered because it requires an attorney serving as a board member to avoid conflicts between the attorney's personal interests (or the attorney's firm's interests) and the attorney's service on the nonprofit board.

A. Conflicts Arising From the Attorney's Role With a Nonprofit and the Attorney's Representation of Another Client

1. When the Attorney's Role Includes Representing the Nonprofit

Standard conflicts analysis applies to a situation where an attorney represents a nonprofit and the nonprofit is currently adverse to another client of the attorney. A direct conflict that cannot be overcome with informed consent always exists when two clients are in litigation with each other. I.R.P.C. 1.7(b)(3).

Direct adversity requiring disqualification (absent informed consent) exists in non-litigated matters where there is "a substantial risk that the lawyer's representation of one or more of the clients would be materially and adversely affected by the lawyer's duties to one or more of the other clients." *Restatement (Third) of Law Governing Lawyers* § 130 (2000). If a lawyer learns during a joint transactional representation that one client's objectives are "materially at variance with those of the other [client]" then a direct conflict exists. *Id.* cmt. c. However, it is important to note that "[d]irect adverseness requires a conflict as to the legal rights and duties of the clients, not merely conflicting economic interests…." ABA LEO 434 (12/8/04).

2. When the Attorney's Role Is Only as a Board Member

Even if a potential representation is not directly adverse to a current client because the attorney does not actually represent the nonprofit, it is still possible the lawyer has a conflict of interest. The duty of loyalty prohibits a lawyer from taking a representation if there is a "significant risk" that the current representation will 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." I.R.P.C. 1.7(a)(2). Consequently, the attorney must not only consider present and past clients, but must also determine if there is some responsibility to a third-party, or a personal interest – like nonprofit board membership – that would "materially limit" the lawyer's ability to represent a client.

An attorney in a situation where a current client and a nonprofit on which the attorney is a board member are somehow adverse should consider two things. First, the attorney should consider whether the attorney possesses confidential information that will affect the advice given to the client or the attorney's service as a board member. Second the attorney should consider whether the attorney's desire to see the client achieve a successful outcome, or the desire to help the nonprofit organization, affects the attorney's ability to give independent professional advice to the client, and to use proper business judgment when participating in board decisions.

B. Conflicts Arising from the Attorney's Dual Role as a Board Member and Attorney for the Organization

An attorney's role as both a board member and legal counsel can give rise to conflicts of interest and the attorney must exercise discretion about whether it is important to act in both roles. I.R.P.C. 1.7, cmt. 35 ("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 should advise the other mem-

The Bottom Line

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bers of the board that in some circumstances matters discussed at board meetings while the 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.") The Restatement similarly gives an attorney discretion about whether dual roles are appropriate:

> [S]imultaneous service … is not forbidden. … The requirement that a lawyer for an organization serve the interests of the entity … is generally consistent with the duties of a director or officer. 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.

Restatement (Third) of Law Governing Lawyers Section 135, cmt. d. Finally, ISBA Advisory Opinion No. 86-14 allows an attorney to act as a member of a not-for-profit board and provide legal services so long as the attorney "does not vote on the issue of his employment."

The comments to Rule 1.7 and the Restatement leave it to the lawyer's discretion as to whether or not to accept the dual roles. ABA Formal Ethics Opinion 98-410 further discussed this situation and attempts to put some parameters on when the lawyer should exercise discretion to take or avoid both roles. The ethics opinion identified four key conflict situations:

- Where the attorney is asked, as an agent of the organization, to pursue objects that the lawyer opposed as a board member;
- Where the attorney is asked to give advice about board actions the attorney took part in;
- Where the board is taking actions that affects the lawyer's firm like whether to retain the firm;
- Where the attorney is representing the nonprofit in an action in which the organization and the board members are parties.

In addition, a conflict situation may arise where the lawyer is asked to give objective legal advice about different options a nonprofit may choose, while the attorney, acting as a board member, favors one of those options over the other.

At a minimum, the attorney should keep these potential conflict situations in mind and should not participate in any board decisions that affect the attorney personally, the attorney's firm, and the attorney's (or attorney's firm's) clients. In addition, the attorney should make sure to obtain informed consent from the nonprofit by informing the board of the dual roles in writing, informing the board of the potential risks, and obtaining written signed consent from the board. ■

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Law firm succession and exit strategies: Coming to terms with aging

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for their succession and retirement. Many of these Generation X lawyers have saved for retirement and are retiring in their 50s. Gen Xers are highly educated, active, balanced, happy, and family oriented. In 2012, the Corporation for National and Community Service ranked Gen X volunteer rates in the U.S. at "29.4% per year, "the highest compared with other generations. This is a generation that values change, a need to combat corruption, dictatorships, abuse, human dignity and individual freedom, the need for stability, love, tolerance, and human rights for all. For Generation X there is more to life than work. This is the generation that believes in work-life balance and that there is more to life than work and career.

Many Baby Boomer lawyers have been so busy living the good life that they have not given any serious thought as to what will happen when the time comes for them to stop working. Coming to terms with aging and retirement can be a difficult time. It requires us to come face to face with our own mortality, which is an uncomfortable subject for all of us. Some senior lawyers have been doing a good job of investing and saving for their retirement through pension, profit sharing, and 401k plans. However, financial preparation is one of the easier components to put in place to ensure a happy retirement.

The Stress of Retirement

In his book, The Retiring Mind, Robert Delamontagne, Ph.D. states "retirement often causes major emotional upheavals on the same level as the death of a love one, loss of a job, or a financial crisis caused by a bad investment. I have come to learn that this emotional distress is often subtle in nature. It doesn't announce itself with fanfare, but sneaks up and taps you on the shoulder."(Delamontagne 2010, 3-16).

The more difficult components of retirement include:

- Coming to terms with aging and the fear of getting older;
- Deciding how to spend your time once you quit working;
- Identifying other interests;
- Preserving your self-esteem after retirement;
- Planning your retirement; and
- Dealing with the stress of retirement.

Achievement Addiction and Preserving Self-Esteem

Many lawyers, more so than many other professionals, are high achievers that are married and addicted to their law practices. They believe that their self-worth is reduced if they are not accomplishing something important. Psychologists refer to this as "achievement addiction." In his book, The Psychology of Retirement, Derek Milne advises that surveys in the United States suggest that over 60 percent of retirees "unretire" and continue to work in some form of paid work, then "re-retire" or semi-retire" later on in their retirement (Milne 2012, 11-05). A major challenge for lawyers that have an achievement-focused personality will be