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Attorneys Serving on Nonprofit Boards of Directors Face Ethical Balancing Acts

By Melissa Longamore, Esq.– June 18, 2012

According to the American Bar Association (ABA) Model Rule of Professional Conduct 6.1, every lawyer has a professional responsibility to render pro bono services to those unable to pay for them. See Model Rule 6.1. Consequently, each year you provide pro bono services to several organizations that serve the poor and disenfranchised. Over the years, you have become known for your hard work, diligence, and balanced approach. As a result, one of the organizations has asked you to join its board of directors. You are honored to have been asked to serve, but you wonder what risks might be associated with your service.

Nonprofit corporations frequently ask attorneys dedicated to public interest and pro bono service to serve on their boards of directors. Service on a nonprofit board can be a great way for an attorney to serve the community and expand his or her community contacts, whether the nonprofit is a house of worship, an educational institution, or a professional association. For nonprofits, attorneys can be valuable assets on a board of directors. Oftentimes, there is an expectation, spoken or unspoken, that an attorney board member will lend his or her legal expertise at little or no cost. This expectation, however, can place the attorney in a precarious ethical position.

While nonprofit board work can be gratifying, attorneys should be mindful of the various ethical and fiduciary duties that may arise while serving on a board of directors. Acknowledging and managing these duties from the outset can ensure that the experience is a rewarding one. This article provides an overview of the duties of nonprofit directors, a brief synopsis of the ethical duties that may arise while serving in this role, and an overview of the protections that are available to attorneys while serving on boards of directors for nonprofit corporations.

Overview of Duties

Generally, nonprofit directors have three primary duties: (1) the duty of care, which refers to the standard of conduct that directors must abide by as they oversee the activities of the organization; (2) the duty of loyalty, which refers to the requirement that directors devote themselves to the organization and its interests exclusively; and (3) the duty of obedience, which refers to the requirement that directors ensure the mission and purpose of the organization are pursued faithfully. Daniel L. Kurtz, Representing & Managing Tax-Exempt Organizations, 2003 WL 23924326, at *7 (2003).

Directors who are attorneys may have additional duties. For example, the report of the Task Force on the Independent Lawyer of the ABA's Section of Litigation indicates that an attorney for a for-profit organization who is also a director is expected to have more extensive knowledge and to conduct more extensive investigations into the facts than other outside directors. As a result, an attorney may be held to a higher standard of care than a director who is not an attorney. ABA Section of Litigation Task Force, Report on the Independent Lawyer 14 (1998). Whether that same heightened duty of care expectation can be extended to attorney-directors serving on

nonprofit boards has not yet been determined.

Possible Ethical Dilemmas

Conflicts of Interest and the Dual Role

When a nonprofit is an existing client of an attorney and the nonprofit then asks the attorney to sit on its board, a dual role is established. More often, however, the nonprofit is not an existing client, and the boundaries of representation are less clear. The attorney may be asked to serve on a board with the expectation that he or she will provide legal advice and services as well. In the latter case, the attorney may not know that the nonprofit has this expectation, as it may be unexpressed.

Unfortunately for those attorneys facing unexpressed expectations from their nonprofits, the existence of an attorney-client relationship is not based on the attorney's expectations. Attorney-client relationships exist when the would-be client has a reasonable expectation under all of the circumstances that the relationship exists. See Togstad v. Vesely, Otto, Miller & Keefe, 291 N.W.2d 686, 693 (Minn. 1980). In addition, attorneys doing pro bono work have the same ethical obligations as attorneys who are paid for their legal services. See Model Rule 6.1. Therefore, it is important that attorneys remain proactive and ask what the nonprofit's expectations are of their services.

If an attorney knows or suspects that an attorney-client relationship exists, the attorney must consider whether or not this possibility presents a conflict of interest. The first step in analyzing conflicts of interest is client identification. Some attorneys mistakenly assume that the client or clients are those individuals with whom they have regular contact—other board members or individual officers within the nonprofit. An attorney who represents a nonprofit, however, represents the entity itself and not the individuals associated with the nonprofit. See Model Rule 1.13. Thus, in most cases, the "client" within the attorney-client relationship will be the nonprofit entity.

The second step to determine whether a conflict of interest exists requires that an attorney consider whether the conflict of interest presents an issue that will require him or her to step out of either role—attorney or board member. The attorney must assess whether there is a substantial risk that the counsel he or she provides to the nonprofit will be materially limited by the attorney's own interest in the matter. See Model Rule 1.7(a)(2). The attorney-client relationship is permitted only if the attorney reasonably believes that he or she can competently and diligently fulfill this role, and the nonprofit consents in writing after being advised of the risks inherent in the situation. See Model Rule 1.7(b). In other words, if there is a significant risk that the attorney's representation of the nonprofit would be materially limited by the attorney's interests as a board member, the attorney may not act as counsel with respect to the matter unless the entity consents after full disclosure. Comment 35 for Model Rule 1.7 provides further insight.

A common conflict-of-interest scenario arises when the nonprofit contemplates a course of action that requires the attorney to support or oppose the action in a manner that makes it difficult for the attorney to provide unbiased legal advice. This could occur when the organization decides to pursue a lawsuit against a third party who also happens to be a former

client of the attorney. Another example is when the attorney is asked to provide advice about the lawfulness of a prior decision by the board in which the attorney-director participated. Due to this prior participation, the attorney may not be able to offer adequately independent legal judgment on the issue.

An attorney serving on a nonprofit board must also be careful not to allow interests in the nonprofit to limit in a material way his or her representation of other clients. For example, an attorney may be asked by another client to make recommendations about charitable gifts. Naturally, the attorney may think of the nonprofit in which her or she is a director. In doing so, the attorney may fail to consider whether or not this gift to the nonprofit is in the best interest or best service of the other client. As a precaution, attorneys should always treat these situations as any other conflict of interest and obtain the client's written consent. The comments for Model Rule 1.7 provide some guidance.

Reporting Wrongdoing

Along with the possibility of conflicts of interest, an attorney may face scenarios in which he or she has to report wrongdoing. According to Model Rule 1.13(b), the duty to report applies when the attorney knows that an officer, employee, or other organization representative has violated a legal obligation that will likely result in substantial injury to the organization. If such a violation exists, the attorney must then determine whether it is reasonably necessary to refer the matter to a higher authority in the organization. As a result, it is necessary that the attorney be aware of the organization's legal duties and assess whether wrongdoing has occurred. An attorney will want to consult his or her state's rules of professional conduct for the equivalent to Model Rule 1.13(b). The comments to Model Rule 1.13 provide some guidance in determining whether referral to someone higher up the chain of command is appropriate.

Attorney Protections—Nonprofit Statutes, Malpractice Insurance, and Director & Officer Liability Insurance

Much of the concern lawyers have for duties, conflicts, and reporting wrongdoing relates to legal liabilities. To be adequately protected from third-party legal action, an attorney must carefully consider what protections are necessary and available. There are three basic protections available in this scenario: nonprofit statutes, malpractice insurance, and director and officer (D&O) liability insurance.

First, the ABA's Model Nonprofit Corporation Act, as well as many state nonprofit statutes, provides liability shields for board directors. Many states have also enacted volunteer protection statutes that curtail, or in some cases eliminate, the liability of nonprofit volunteer directors. Janine Greenwood, "Questions Lawyers Should Ask Before Joining a Nonprofit Board," 28 ACC Docket 34, 41 (Issue No. 1, 2010). Nonprofit statutes can serve as a starting point for attorneys who are considering what kind of malpractice and liability insurance is necessary for the particular type of nonprofit board service.

It is important to note, however, that nonprofit statute protections have important limitations of which attorney board members should be mindful. For instance, most nonprofit statutes do not apply to trade or professional association board service. Id. These statutes also do not protect directors against the initial legal expenses of defending against the filing of a claim, even if it is

later dismissed under the charitable immunity. Id.

Second, if an attorney expects that his or her service on a nonprofit board will include some level of legal representation or the giving of advice, malpractice coverage is an important source of liability protection. Pro bono activities can lead to malpractice suits, and attorneys should therefore examine their malpractice coverage details to confirm that pro bono service is also covered. See Model Rule 6.1. This is important because many attorneys rely on malpractice coverage through their employers, which may not cover outside service work.

Third, a nonprofit should have its own liability protections in place, including D&O insurance coverage. Attorneys should ask for a copy of the D&O coverage binder and review the plan's limits and exclusions. Id. Procedures should be established that require the board to review annually the overall insurance coverage and confirm that it adequately meets the needs of the nonprofit. Id. It is also important to note that D&O coverage will protect attorney board members while acting as board members but not when rendering professional advice to the nonprofit. Id. It is important that attorneys are mindful of these protections and their coverage limitations. For smaller nonprofits such as neighborhood associations, D&O insurance may be cost prohibitive for the organization. In such a case, the attorney should consider contacting his or her homeowner's or renter's insurance agent to see whether a general liability umbrella policy will cover the attorney individually in a manner similar to D&O insurance.

Conclusion

Although an attorney's pro bono service may be rendered free of charge, a lack of due diligence on the part of the attorney regarding the organization could cost him or her in the end. Before committing to serve on a nonprofit's board of directors, attorneys must review the various local and national laws governing their ethical and fiduciary duties—and observe them during service. Attorneys who fail to do so may face serious ethical charges that could have been easily avoided.

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