

# Hat Tricks: Legal, Ethical, and Practical Considerations for Managing In-House Nonprofit Counsel's Many Roles

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**Diara M. Holmes and Marcus S. Owens**  
**Tax-Exempt and Nonprofit Organizations Practice**  
**Loeb & Loeb LLP**



**Rhonda Lees**  
**Vice President & Senior Counsel**  
**American Bankers Association**

# “Hat Tricks”

## AGENDA

**ABA Model Rules and VA Professional Guidelines and Rules of Conduct  
Rules 1.13 (Who’s the Client?) and 1.7  
(Conflicts of Interest: Current Clients)**

### **Investigations**

- Upjohn warning
- Post-Investigation--Communicating Results without Compromising Confidentiality

**Related Party Transactions and Other Scenarios To Consider**

## Fundamentals: Who's the Client?

- ABA Model Rule 1.13(a):

*“a lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents”*

- Virginia Professional Guidelines and Rules of Conduct Rule 1.13(a)—  
same rule.

# Model Rules of Professional Conduct

## Rule 1.13(f):

“In dealing with an organization’s directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization’s interests are adverse to those of the constituents with whom the lawyer is dealing.”

## Rule 4.3:

“In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer’s role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding.”

## VA Professional Guidelines and Rules of Professional Conduct

### Rule 1.13(d):

“In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when it is apparent that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.”

### Rule 4.3(a):

“In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding..”

# Fundamentals: Concurrent Conflicts of Interest

## ABA Model Rule 1.7:

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

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

OR

(2) there is a significant risk that the representation of one or more clients 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.

## Fundamentals, cont. Concurrent Conflicts of Interest

### ABA Model Rule 1.7, cont.:

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

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

(2) the representation is not prohibited by law;

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

AND

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

# Fundamentals. Conflicts of Interest: General Rule

## VA Professional Guidelines and Rules of Professional Conduct Rule 1.7:

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

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

OR

(2) there is a significant risk that the representation of one or more clients 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.



## Fundamentals, cont. Conflicts of Interest: General Rule

VA Professional Guidelines and Rules of Professional Conduct Rule 1.7, cont.:

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph(a), a lawyer may represent a client if each affected client consents after consultation, and:

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

(2) the representation is not prohibited by law;

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

AND

(4) the consent from the client is memorialized in writing.

## *Educating Staff re: Counsel's Role; Day-to-Day Engagement*

- **Proactively educate staff and board about your role as in-house counsel:**
  - General role of corporate counsel and who counsel represents
  - What constitutes legal advice and attorney-client privilege (when it's owed --- also lost)
  - Consider including this topic as part of board orientation
- **Establish a process where only the legal department can retain outside counsel.**
- **If staff or board members contact you directly for legal-oriented advice, consider disclaimers + issue *Upjohn* warnings as needed (covered shortly).**

## Scenario: Colleague Seeks Personal Legal Advice

Your colleague and friend, the Chief Operating Officer, stops by your office asking to “pick your legal brain” about the terms of her employment contract with the nonprofit you both work for. You did not draft her contract (the nonprofit has outside employment/labor counsel). She goes so far as to place a folder on your desk, and proceeds to read the termination/severance provisions aloud to get your opinion.

How should you respond?

- (A) Give her your best advice, as a friend.
- (B) Inform her that you cannot provide legal advice.
- (C) Offer to refer her to competent counsel.

## POTENTIALLY TRICKY “MULTIPLE HAT” SITUATIONS FOR IN-HOUSE COUNSEL

- **Investigations (e.g., allegations against a C-suite executive)**
- **For 501(c)(3)s and 501(c)(4)s: Navigating transactions between the nonprofit client organization and one of its disqualified persons (potential excess benefit transactions or self dealing)**
- **Association Counsel Example**

## Internal Investigations

- **Who is the client? Preserving attorney-client privilege w/ the *Upjohn* warning.**
- **Post-investigation: Communicating results without compromising confidentiality.**
- **Protect the victim or whistleblower from retaliation.**

## *Upjohn Warning*

- *Upjohn Co. v. U.S., 449 U.S. 383, 394-395 (1981)*

*Attorney-client privilege covers communications between corporate counsel and corporate constituents re: subjects within scope of their duties for purposes of providing legal advice to the company.*

- Why is the warning of critical importance? In order to retain the organization's power to decide whether/when to waive privilege, Counsel must clarify at the outset of an interview that the A-C privilege is between counsel and the organization; not the individual.

## *Upjohn* Warning – Elements

- The lawyer represents organization only and not the witness personally.
- The lawyer is collecting facts for the purpose of providing legal advice to the organization.
- The communication is protected by the attorney-client privilege, which belongs exclusively to the organization, not the witness.
- The organization may choose to waive the privilege and disclose the communication to a third-party, including the government.
- The communication must be kept confidential, meaning that it cannot be disclosed to any third party other than the witness's counsel.

## *Upjohn* Warning – Practice Tips

- Write it down, to ensure consistent delivery. Have a script in your file for the investigation.
- Counsel's memo to file should note that *Upjohn* warning was delivered.
- Memorialize the interviewee's acknowledgement of the warning, via counter-signature.



## *When to Retain Outside Counsel*

**Whether it's necessary, advisable, or just potentially helpful depends on CONTEXT.**

- The in-house GC is conflicted – e.g., issue arises between affiliated entities, and you're the GC for both.
- Crisis is brewing, and time is of the essence. Outside help can expand your team's bandwidth.
- The matter requires specialized expertise, experience or relationships (e.g., tax, EEOC, state AG investigation).
- The controversy puts the CEO at odds with the Board. Privacy, sensitivity, and dynamics may necessitate engaging outside counsel to weigh in.
- Internal policy or protocols may require taking the matter off of the in-house GC's desk – for example, in the case of workplace allegations involving C-level or a Board member.
- Sheer volume of work may require additional support (e.g., doc production in Litigation).

# Protect Victims/Whistleblowers from Retaliation

- Retaliation= adverse action as a result of someone engaging in protected activity (e.g., filing a claim or providing information in an internal investigation).
- Prohibited retaliation may include:
  - work-related threats, warnings, or reprimands;
  - negative or lowered evaluations;
  - transfers to less prestigious or desirable work or work locations;
  - threatening reassignment; scrutinizing work or attendance more closely than that of other employees, without justification;
  - removing supervisory responsibilities;
  - abusive verbal or physical behavior that is reasonably likely to deter protected activity, even if it is not yet "severe or pervasive" as required for a hostile work environment;
- During the investigation, communicate to all parties that retaliation won't be tolerated, as it would be a separate and additional violation of HR policy (and possibly the law). Make sure subsequent retaliation concerns are reported and investigated, too.

# Post-Investigation: Communicating Results

After being interviewed, naturally cooperating staff members will want to know what happened, and whether anything was done. What can you report back to them without compromising the affected parties' privacy or confidentiality of the process?

- The organization followed policy in conducting the investigation, and it's concluded.
- Findings? Organization policy was/was not violated in this instance.
- Disciplinary action was taken/not taken (no names).
- In practice, can help to be transparent about what you can't be transparent about

## Navigating Related-Party Transactions

- **For the in-house GC, transactions among affiliated entities, or between the nonprofit and individual related parties, can create a minefield of potential conflicts and challenges — both legal and “political.”**
- **Pay attention to the fundamentals: who’s your client? If the transaction involves two entities, are you counsel to both? Is there a conflict, or could one arise? You’ll need to assess these questions, communicate effectively to interested parties, chart a course, and proceed with caution.**
- **In the tax area: these issues often manifest as Excess Benefit Transactions and Self Dealing.**

# IRS Audit re: Potential Excess Benefit Transaction (IRC Section 4958)

## Situation:

The IRS has opened an audit of your Nonprofit's FY 2019 Form 990, for alleged excessive compensation paid to the CEO, who is still present. In your initial call with the IRS agent handling the audit, it becomes clear that the government is considering penalties under IRC section 4958 -- for both the CEO and the Board members who approved the compensation. The initial set of IDR requests, among other things, the CEO's employment contract and benefits plans, minutes of Board and Compensation Committee meetings, and all correspondence regarding the CEO's compensation.

The CEO informs you that she, too, received notice that her personal tax return is under audit. During this conversation, she mentions that she negotiated directly with the Board Chair, outside the routine compensation approval process, for a performance bonus that year. There are no records of this conversation, and the Board Chair denies ever having it.

## Issue Spotting step 1: Identify the (potentially conflicting) Interests

- (1) the CEO, who may face personal liability for excise tax under 4958.
- (2) Board members: some voted Yes, others voted No, on the base compensation at issue. Were they aware of the bonus? Was total comp approved? Can they claim the “rebuttable presumption”?
- (3) The Board Chair: allegedly negotiated a side agreement with the CEO outside the Bylaws-approved process.
- (4) the Nonprofit (**Your Client**): (a) may be owed repayment of the excess compensation paid. (b) may be facing potential revocation of exempt status if the IRS believes private inurement or a pattern is implicated (c) governance concerns re: Board Chair role and overall compensation setting process.

## Variation: Self-Dealing Transactions (IRC Section 4941)

- **Similar to the Intermediate Sanctions scenario, inherent conflicts of interest arise for the in-house lawyer who is employed by a for-profit Company and also working for its affiliated private foundation.**
- **Key distinction: IRC section 4941 self-dealing rules are more strict. Most transactions with the DP are strictly prohibited. Unlike 4958, the fact that a transaction is at arm's length/FMV is no defense.**
- **What happens when the IRS audits the foundation's Form 990-PF for a potential self-dealing transaction involving the Company as DP? Who is your "client"? How should the in-house attorney navigate this conflict?**

## Engaging Other Experts to Assist Counsel – Further Mitigating Risk

- It may be helpful to engage experts—for example, to support the organization’s position that the transaction with a related party/DP was fair to the EO, and to defend Officers/Directors against manager’s tax liability, based on “reliance on professional advice.”
  - Compensation Consultants, Appraisers, Valuation Experts, Crisis Comms team.
- To preserve Attorney-Client privilege on the subject matter, engage consultants through Counsel under a *Kovel* letter agreement.
- Agreement should set forth: scope of engagement, purpose of assisting Counsel in delivering legal advice to client, reporting authority, and payment/invoicing arrangements.



## Scenario: Association Counsel reviewing concerns about member

Your association oversees industry-focused certifications. You receive an anonymous complaint claiming that an association member (individual) is misrepresenting their certification status on LinkedIn.

- Threshold considerations? Any conflicts to navigate?
- Should Counsel reach out to the individual?
- If they're affiliated with an Association member company/institution, should communication go through the institution first?
- When might you disclose the complaint to a regulator?
- Privacy concerns?

# QUESTIONS





# Diara M. Holmes

dholmes@loeb.com

Co-Chair, Nonprofits & Tax-Exempt Organizations;  
Co-Chair, Loeb & Loeb's Attorneys of Color and Ethnic Diversity Affinity Group

Diara M. Holmes serves as co-chair of the firm's Tax-Exempt Organizations Practice. She brings 20 years of experience, regularly counseling tax-exempt organizations, including large public charities; colleges, universities and other higher education organizations; foreign charities and their U.S. affiliates; associations; government instrumentalities; social welfare organizations; and religious organizations on a broad range of tax compliance and governance issues.

She advises nonprofit and for-profit organizations on structuring a variety of transactions—including joint ventures, corporate sponsorships, merchandising, cause-related marketing, and other revenue generating strategies. In addition, she works with high net worth individuals and families to establish family foundations and donor-advised funds.

Diara has represented numerous organizations before the IRS—navigating complex audits involving an array of issues (e.g., executive compensation, unrelated business tax, and political campaign intervention); seeking private letter rulings regarding proposed transactions, requesting determination letters regarding public charity classification, applying for exempt status, and seeking reinstatement of exempt status following auto-revocation.

Diara is a frequent speaker at national professional conferences on exempt organizations issues and serves on the board of directors of both the Washington Area Women's Foundation and N Street Village.

## Recognition

- Named "Washington, DC Super Lawyer" in Nonprofit Organizations by Thomson Reuters (2020-2021)
- Named "Best Lawyer" in Tax Law by The Best Lawyers in America (2019-2020)
- Named in The Legal 500 US in Nonprofit and Tax Exempt Organizations, published by Legalease Limited and John Pritchard (2013, 2017-2020)
- Named to the District of Columbia Courts 2018 Capital Pro Bono Honor Roll

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# Marcus S. Owens

mowens@loeb.com

Partner

Marcus Owens represents a broad range of nonprofit organizations, including private foundations, charities, lobbying/political organizations and trade associations. The context has ranged from tax planning, the process of formation and application for exemption, through IRS and state attorney general investigations, including complex audits by IRS Exempt Organizations Financial Investigative Units. Marcus' focus includes executive compensation, excess benefit and self-dealing excise taxes, as well as the impact of digital and social media on tax exempt organizations. His experience also extends to social impact investing and program-related investments. Particular projects have involved the emerging rules for foreign grant making and organizations interested in public policy but concerned with legislative and political activities. Marcus is also a frequent lecturer, writer and commenter on the complex laws affecting exempt organizations.

Prior to entering private practice, Marcus was employed by the Exempt Organizations Division of the Internal Revenue Service and served as the division's director for ten years. In that capacity, he was the chief decision maker regarding design and implementation of federal tax rulings and enforcement programs for exempt organizations, political organizations and tax-exempt bonds. He also served as the IRS's primary liaison with other federal agencies, Congress, and state regulators on exempt organizations issues.

## Recognition

- Named "Best Lawyer" in Trusts and Estates Law (2008-2017), Tax Law (2018-2020) and Non-Profit / Charities Law (2018-2020) by The Best Lawyers in America.
- Named as a "Leading Lawyer" in The Legal 500 US in NonProfit and Tax Exempt Organizations, published by Legalease Limited and John Pritchard (2011, 2013-2014 and 2016-2020)

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