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Plaintiffs' Reply to Defendants' Opposition to Plaintiffs' Motion to Disqualify Defendants' Counsel

Plaintiffs, The People of the State of California, *ex rel.*, Carol Spooner, et al., submit the following reply to Defendants' opposition to their motion to disqualify Defendants' counsel.

I. Plaintiffs Have Standing to Bring the Motion.

The cases cited by Defendants regarding standing are inapposite. *In re Lee v. San Diego County Department of Social Services*, 1 Cal.Rptr.2d 375 (1991), and the case it cited, *Civil Service Com. v. Superior Court*, 209 Cal.Rptr. 159 (1984), are not shareholder derivative-type cases such as this case.

This case is brought on behalf of Pacifica Foundation, which is named as a nominal defendant, for wrongs against the Foundation by its officers and directors, and the Foundation stands to benefit in money damages against its officers and directors if Plaintiffs prevail.

The case law is well-developed and extensive that in analogous shareholder derivative-type actions, the plaintiffs may object to dual representation of named individual defendant officers and directors and the corporate entity, even when the plaintiffs do not establish that they, personally, have or had an attorney-client relationship with the attorney. In *In re Oracle Securities Litigation,* 829 F.Supp. 1176, 1188 (N.D. Cal. 1993), the Court *on its own initiative* inquired into the dual representation of allegedly disinterested directors and the corporate entity, found it improper, and refused to approve a settlement agreement on that basis. Similarly, the Court of Appeals for the District of Columbia Circuit, addressing the analogous problem of dual representation of a union and union officials in actions brought on behalf of the union, has indicated that it would always require separate counsel for a corporation in a shareholder's

derivative action. *Yablonski v. United Mine Workers of America,* 448 F.2d 1175, 1181 (1971), *cert. denied,* 406 U.S. 906, (1972). *See also, Musheno v Gensemer*, 897 F. Supp 833 (M.D. Pa 1995); *Messing v. FDI, Inc.*, 439 F. Supp. 776 (D. NJ 1977); *Lewis v. Shaffer Stores Co.* 218 F.Supp. 238 (SDNY 1963); *Murphy v. Washington American League Base Ball Club*, 324 F.2d 394, 397-398 (DC Cir 1963).

II. Defendants Present No Evidence of "Full Disclosure and Informed Written Consent" to the Dual Representation by Wendel, Rosen, Black & Dean, LLP, or Epstein Becker & Green, P.C.

Under California Rules of Professional Conduct, Rule 3-310, "Disclosure" means informing the client of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the client. Defendants submit a "Sample of Email Sent to Foundation Directors" by Epstein Becker & Green ("EB&G") attorney Daly D.E. Temchine. (Opposition, 4:6-7; *See* Declaration of Temchine, Exhibit A.) This email is most notable for what it does *not* inform the directors, e.g., the nature of the potential conflicts of interests between the directors and the Pacifica Foundation, and between some directors who are accused of breach of charitable trust and against whom damages are sought on behalf of Pacifica and other directors who are not alleged to have participated in breaches of trust but are alleged to have been unlawfully elected; and (2) the possible adverse consequences and risks involved.

Defendants also submit the Declaration of Wendel, Rosen, Black & Dean ("WRB&D") attorney Daniel Rapaport. Mr. Rapaport recites at length the factors *he* evaluated to determine lack of conflicts of interest. Notably, he does not state what relevant circumstances and actual and reasonably foreseeable adverse consequences he disclosed in writing to the Defendants that

would allow *the Defendants* to determine a lack of conflicts of interest or to give informed consent to any conflicts of interest which *the Defendants* might determine to exist.

Under California Rules of Professional Conduct, Rule 3-310, "Informed written consent" means the client's written agreement to the representation following written disclosure. Defendants submit no written agreements signed by *any* of the Defendants to the dual representation of EB&G or WRB&D. Further, under California Rules of Professional Conduct, Rule 3-600, subsection (E):

> "A member representing an organization may also represent any of its directors, officers, employees, members, shareholders, or other constituents, subject to the provisions of rule 3-310. If the organization's consent to the dual representation is required by rule 3-310, the consent shall be given by an appropriate constituent of the organization other than the individual or constituent who is to be represented, or by the shareholder(s) or organization members."

Under this rule, the appropriate "constituents" to consent on behalf of the organization to the dual representation would appear to be the directors that EB&G and WRB&D do *not* represent, or the members of the Pacifica Foundation (i.e., the Local Advisory Board Members).

III. Plaintiffs Have Alleged With Particularity Multiple Breaches of Directors' Fiduciary Duties and Multiple Causes of Action Which Are Breaches of the Directors' Duty of Loyalty and Which Would Result in Personal Liability in Damages to Pacifica on the Part of Some of its Directors and Officers if Plaintiffs Prevail.

The First Cause of Action of the Complaint is for Breach of Charitable Trust[1], which

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[1] Defendants attempt to characterize this action as purely a *quo warranto* action, apparently because Plaintiffs' Third, Fourth, and Fifth Causes of Action seek removal of directors for usurpation of office on various grounds. (Memorandum of Points and Authorities in

includes allegations of bad faith and conspiracy in diverting Pacifica from its founding purposes and engaging in *ultra vires* activities. The Second Cause of Action is for Gross Abuse of Authority and Discretion. The Sixth Cause of Action is for an Accounting, not only of wrongly expended and wasted funds in preparation for and carrying out the armed occupation and shutdown of radio station KPFA, but also of alleged irregularities in Pacifica's accounts going back several years (including, without limit, payments for space not built in the construction of studios for station WPFW and requiring WBAI personnel to sign blank checks, at Complaint, Paragraph 41) to determine whether or not there have been misappropriations of funds and who is responsible. The Complaint makes detailed factual allegations of intentional wrongdoing, not mere negligence, and of intentional falsehoods, deceptive practices and patterns of deceit, involving successive officers and directors over a period of several years, in order to carry out a plan to divert Pacifica from its founding purposes and to engage in *ultra vires* activities.

Opposition to Motion to Disqualify Wendel, Rosen, Black & Dean, LLP as Defendants' Counsel, 1:17-18.)

Defendants attempt to trivialize these allegations as "political rhetoric." (Memorandum of Points and Authorities in Opposition to Motion to Disqualify Wendel, Rosen, Black & Dean, 1:4-6.) Defendants have forgotten that Pacifica was founded by Pacifists shortly after World War II for a political purpose – "to contribute to a lasting understanding between nations and between the individuals of all nations, races, creeds and colors; to gather and disseminate information on the causes of conflict between any and all of such groups; and through any and all means compatible with the purposes of this corporation, to promote the study of political and economic problems and the causes of religious, philosophical and racial antagonisms."[2] (Articles of Incorporation, Article II (d), as Amended August 20, 1948, attached as "Exhibit A"to the Declaration of Thiele R. Dunaway filed in Support of Defendants' Opposition to Motion to Remand.) For that reason, among others, Pacifica is not an ordinary business corporation, nor even an ordinary nonprofit educational radio broadcast licensee, and the introduction of armed guards into a Pacifica radio station (at an estimated cost of over $300,000) in order to "shut down and reprogram that unit" was a shocking and serious breach of trust, lacking any true business purpose, and not an ordinary action permitted under the "business judgment rule." Plaintiffs' allegations amount to far more than a breach of directors' duty of care.

> "We have no hesitation in holding that -- except in patently frivolous cases -- allegations of directors' fraud, intentional misconduct, or self-dealing *require separate counsel*. We recognize that corporate law has traditionally distinguished between breach of the duty of care and breach of the duty of loyalty, the latter

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[2] While issues of national politics have moved from the Florida courts to the United States Supreme Court, and one witnesses on television mobs storming election headquarters attempting to prevent the counting of ballots in a national presidential election by a court-ordered deadline, one may be given pause to ponder that the vision and purpose of Pacifica's founders may still be needed in American broadcast media today.

> being more grave. See Del. Code Ann. tit. 8 §§ 102(b)(7) (charter amendment provision allowed to limit director liability for breaches of duty of care but 'such provision shall not eliminate or limit the liability of a director: . . .for any breach of the director's duty of loyalty'); William A. Klein & John C. Coffee, Jr., Business Organization and Finance 138-43, 152-58, 182 & n.97 (1990) (discussing distinction between duties of care and loyalty). But drawing the line between breaches of care and loyalty may be difficult in many cases. See Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 103 (1991) ('Ultimately, though, there is no sharp line between the duty of care and the duty of loyalty.')."

Bell Atlantic Corporation v. Bolger, 2 F.3d 1304, 1317 (3rd Cir. 1993) (emphasis added).

In this case, where directors and officers are accused of conspiring in bad faith to breach a charitable trust and to waste trust assets engaging in *ultra vires* activities, if Plaintiffs allegations are proven, some directors and officers will be liable in damages to the corporation. Dual representation of these directors and officers and the Foundation clearly should not be permitted.

IV. Defendants' Do Not Address the Issue of Imputed Disqualification of Defendant Murdock's Law Firm.

As argued in Plaintiffs' moving papers, defendant director Murdock is clearly disqualified from representing the Pacifica Foundation, or any defendant other than himself, in this matter. Defendants have not presented *any* evidence of consent after consultation including "explanation of the implications of the common representation and risks involved," as required under ABA Model Rule 1.7. Mr. Murdock's disqualification is imputed to every other attorney employed by Epstein Becker & Green, P.C., under ABA Model Rules of Professional Responsibility, Rule 1.10. The rule of imputed disqualification is consistently followed by the California courts. *Trone v. Smith,* 621 F.2d 994, 999 (9th Cir. 1980); *People v. Speedee Oil Change Systems, Inc.*, 20 Cal.4th 1135, 1139 (1999); *Henricksen v. Great American Savings and Loan,* 11 Cal.App.4th

109 (1992).

Defendants have not presented any argument in their Opposition briefs that EB&G should not be disqualified from representing *any* party to this matter on this basis.

V. Defendant Murdock Does Have a Material and a Financial Interest in the Epstein Becker & Green Law Firm.

Defendants cite no case authority to support their assertion that defendant Murdock's interest in the hiring of his law firm to represent Defendants in this case is not a "material interest." While Mr. Murdock states that he is an "income partner" and not an "equity shareholder" of EB&G (Temchine Declaration, Exhibit C, Affidavit of John M. Murdock), that does not mean that he does not benefit from the profitability of EB&G when it comes time to determine his income, as he explained it, nor does it mean that he does not receive other benefits by reason of procuring business for the firm, including favorable treatment when it comes to promotion from "income partner" to "equity shareholder."

The California Corporations Code does not define "material interest," and Plaintiffs have not been able to find any case law defining it in this context. However, the California Government Code defines "financial interest" in the context of public officials[3], and there is no

[3] California Government Code § 87103. Financial interest A public official has a financial interest in a decision within the meaning of Section 87100 if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official, a member of his or her immediate family, or on any of the following: (a) Any business entity in which the public official has a direct or indirect investment worth one thousand dollars ($ 1,000) or more. (b) Any real property in which the public official has a direct or indirect interest worth one thousand dollars ($ 1,000) or more. (c) Any source of income, other than gifts and other than loans by a commercial lending institution in the regular course of business on terms available to the public without regard to official status, aggregating two hundred fifty dollars ($ 250) or more in value provided to, received by or promised to the public official within 12 months prior to the time when the decision is made. (d) Any business entity in which the public official is a director, officer, partner, trustee, employee, or holds any position of

reason that the standard should be less stringent for fiduciaries of nonprofit public benefit corporations and charitable trusts, nor is there any reason to believe that "material interest" is not a broader concept than mere "financial interest."

VI. Defendants' Own Evidence Shows that They Did Not Comply With California Corporations Code §5233, Regarding Transactions With Interested Directors.

As set forth in Plaintiffs' moving brief, where it is not reasonably practicable for the board to grant prior approval of a transaction with an interested director, a self-dealing transaction may be allowed, if the board ratifies the transaction by majority vote of the disinterested directors in office at the next board meeting. California Corporations Code §5233 requires the self-dealer must prove that:

(1) the corporation entered into the transaction for its benefit;

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management. (e) Any donor of, or any intermediary or agent for a donor of, a gift or gifts aggregating two hundred fifty dollars ($ 250) or more in value provided to, received by, or promised to the public official within 12 months prior to the time when the decision is made. The amount of the value of gifts specified by this subdivision shall be adjusted biennially by the commission to equal the same amount determined by the commission pursuant to subdivision (f) of Section 89503. For purposes of this section, indirect investment or interest means any investment or interest owned by the spouse or dependent child of a public official, by an agent on behalf of a public official, or by a business entity or trust in which the official, the official's agents, spouse, and dependent children own directly, indirectly, or beneficially a 10-percent interest or greater.

(2) at that time, the transaction was fair and reasonable as to the corporation;

(3) a majority of the entire existing board (and not just a committee), without counting the vote of the interested director(s), and with knowledge of all the material facts concerning the transaction and the director's interest, approved or authorized the transactions; and

(4) the board considered and in good faith determined after an investigation reasonable under the circumstances that the corporation could not have obtained a more advantageous arrangement.

Here, Defendants do not establish that it was not practicable for the board to pre-approve the transaction at the June 2000, meeting of the board of directors, or even that the transaction was ratified at the *next* meeting after the hiring took place. (Plaintiffs do not admit that it has been ratified at *any* board meeting to date.) The board met on June 11, 2000. (Spooner Declaration in Support of Motion to Disqualify Defendants' Counsel.) Apparently EB&G was hired by the Executive Director to represent Pacifica in the related state court case, *Adelson, et al. v Pacifica, et al,* some time in June 2000, whether before or after June 11, 2000 is uncertain. (Temchine Declaration in Support of Opposition to Disqualification, Exhibit D, Transcript, 43:13-16.)

In any case, the transcript supplied by Defendants of the September 17, 2000, board meeting (Temchine Declaration, Exhibit D), where the Defendants assert that the board "ratified" the transaction, shows:

1) that several directors complained that they did not learn (other than by rumors) that the hiring had taken place until they arrived at the meeting. (Transcript,

39:20-40:8; 44:10 - 46:8.);

2) that the terms of the transaction were not revealed to the directors at the September 17th meeting. (Transcript, 38:9-16, 51:3-5); and

3) that the board was prevented by the Chair (defendant Berry) from making the inquires necessary to considering and making in good faith a determination after an investigation reasonable under the circumstances that the corporation could not have obtained a more advantageous arrangement. (Transcript, 37:19 - 64:6, passim.)

The transcript provided by Defendants does *not* show that the September 13, 2000, letter-opinion of attorney John Crigler (Temchine Declaration, Exhibit E) was provided to the directors (except, perhaps some Executive Committee Members) prior to or at any time during the September 17th board meeting.

To the extent that a majority of the board voted not to discharge EB&G, they certainly did not do so under circumstances that meet their fiduciary duties under the requirements of §5233 of the California Corporations Code. Even a motion to meet again by conference call to discuss the matter was defeated by the board majority under the control of the Chair. (Transcript, 56:9 - 60:12..)

VII. Defendants Have Not Established that Representation By EB&G Provides *Any* Benefit to the Corporation, and Their Evidence Suggests that Such Representation is Not in the Financial Best Interests of the Corporation.

Defendants assert that "EBG is providing services to the Foundation at a significantly discounted rate," and that "it would impose a significant financial burden on the defendants if EBG were disqualified." (Foundation Defendants' Opposition to Plaintiffs' Motion to Disqualify

Epstein Becker & Green, P.C. as Counsel, 12:12-17.) Mr. Temchine, in his email to Ms. Cagan (Temchine Declaration, Exhibit A), explains: "The utility to the Foundation of multiple representations by its counsel is that, if feasible, it conserves its assets as represented by its D&O insurance policy." But the Defendants do not explain how paying a "discounted rate" to EB&G for attorneys' services is more beneficial to the corporation than calling upon its Directors and Officers liability insurer to defend the case at *no expense* to the corporation (except, perhaps a deductible). Presumably, the insurer is obligated to provide the directors with defense counsel under the terms of the policy.

Finally, the fact that Pacifica is apparently paying for the defense of its directors out of corporate funds raises serious issues of propriety, in and of itself, under California Corporations Code §5238.[4]

Even in the context of a for profit corporation, such payments for directors' defense costs are risky.

> "As to the propriety of the corporation's paying the legal expenses and counsel fees of the individual defendants in the present litigation, we think final settlement of this question must await the termination of the suit. If in the light of the result of the litigation and applicable provisions of law the individual defendants are found to be entitled to indemnification in whole or in part, the corporation can, of course, effect such indemnification. If the directors authorize payments of this sort by the corporation prior to final judgment, they do so at the risk of being held liable to the corporation for the amounts of any such payments which are ultimately determined to have been improper. Whether they or the corporation can or should be enjoined from making any payments prior to final judgment is not before us: no request was made for such an injunction."

Murphy v. Washington American League Base Ball Club, 324 F.2d 394, 398 (D.C. Cir. 1963) (footnotes omitted).

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[4] Due to its length, §5238 is appended at the end of this brief.

Conclusion.

For all the foregoing reasons, Plaintiffs' motion to disqualify Defendants' counsel, Epstein Becker & Green, P.C., and Wendel, Rosen, Black & Dean, LLP, from dual representation of Pacifica and its officers and directors, and to disqualify Epstein, Becker & Green from representing any party in this matter, should be granted.

Dated: _________ Respectfully submitted,

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DANIEL ROBERT BARTLEY

APPENDIX

CORPORATIONS CODE
TITLE 1. CORPORATIONS
DIVISION 2. NONPROFIT CORPORATION LAW
PART 2. NONPROFIT PUBLIC BENEFIT CORPORATIONS
CHAPTER 2. Directors and Management
ARTICLE 3. Standards of Conduct
Cal Corp Code §§ 5238 (2000)

§§ 5238. "Agent"; "Proceeding"; "Expenses"; Power of corporation to indemnify person threatened to be made party to proceeding; Indemnification of agent for expenses incurred; Purchase of liability insurance on behalf of corporate agent; Applicability of section

(a) For the purposes of this section, "agent" means any person who is or was a director, officer, employee or other agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another foreign or domestic corporation, partnership, joint venture, trust or other enterprise, or was a director, officer, employee or agent of a foreign or domestic corporation which was a predecessor corporation of the corporation or of another enterprise at the request of such predecessor corporation; "proceeding" means any threatened, pending or completed action or proceeding, whether civil, criminal, administrative or investigative; and "expenses" includes without limitation attorneys' fees and any expenses of establishing a right to indemnification under subdivision (d) or paragraph (3) of subdivision (e).

(b) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any proceeding (other than an action by or in the right of the corporation to procure a judgment in its favor, an action brought under Section 5233, or an action brought by the Attorney General or a person granted relator status by the Attorney General for any breach of duty relating to assets held in charitable trust) by reason of the fact that such person is or was an agent of the corporation, against expenses, judgments, fines, settlements and other amounts actually and reasonably incurred in connection with such proceeding if such person acted in good faith and in a manner such person reasonably believed to be in the best interests of the corporation and, in the case of a criminal proceeding, had no reasonable cause to believe the conduct of such person was unlawful. The termination of any proceeding by judgment, order, settlement, conviction or upon a plea of nolo contendere or its equivalent shall not, of itself, create a presumption that the person did not act in good faith and in a manner which the person reasonably believed to be in the best interests of the corporation or that the person had reasonable cause to believe that the person's conduct was unlawful.

(c) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action by or in the right of the corporation, or brought under Section 5233, or brought by the Attorney General or a person granted relator status by the Attorney General for breach of duty relating to assets held in

charitable trust, to procure a judgment in its favor by reason of the fact that such person is or was an agent of the corporation, against expenses actually and reasonably incurred by such person in connection with the defense or settlement of such action if such person acted in good faith, in a manner such person believed to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances. No indemnification shall be made under this subdivision:

(1) In respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation in the performance of such person's duty to the corporation, unless and only to the extent that the court in which such proceeding is or was pending shall determine upon application that, in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for the expenses which such court shall determine;

(2) Of amounts paid in settling or otherwise disposing of a threatened or pending action, with or without court approval; or

(3) Of expenses incurred in defending a threatened or pending action which is settled or otherwise disposed of without court approval unless it is settled with the approval of the Attorney General.

(d) To the extent that an agent of a corporation has been successful on the merits in defense of any proceeding referred to in subdivision (b) or (c) or in defense of any claim, issue or matter therein, the agent shall be indemnified against expenses actually and reasonably incurred by the agent in connection therewith.

(e) Except as provided in subdivision (d), any indemnification under this section shall be made by the corporation only if authorized in the specific case, upon a determination that indemnification of the agent is proper in the circumstances because the agent has met the applicable standard of conduct set forth in subdivision (b) or (c), by:

(1) A majority vote of a quorum consisting of directors who are not parties to such proceeding;

(2) Approval of the members (Section 5034), with the persons to be indemnified not being entitled to vote thereon; or

(3) The court in which such proceeding is or was pending upon application made by the corporation or the agent or the attorney or other person rendering services in connection with the defense, whether or not such application by the agent, attorney or other person is opposed by the corporation.

(f) Expenses incurred in defending any proceeding may be advanced by the corporation prior to the final disposition of such proceeding upon receipt of an undertaking by or on behalf of the agent to repay such amount unless it shall be determined ultimately that the agent is entitled to be

indemnified as authorized in this section. The provisions of subdivision (a) of Section 5236 do not apply to advances made pursuant to this subdivision.

(g) No provision made by a corporation to indemnify its or its subsidiary's directors or officers for the defense of any proceeding, whether contained in the articles, bylaws, a resolution of members or directors, an agreement or otherwise, shall be valid unless consistent with this section. Nothing contained in this section shall affect any right to indemnification to which persons other than such directors and officers may be entitled by contract or otherwise.

(h) No indemnification or advance shall be made under this section, except as provided in subdivision (d) or paragraph (3) of subdivision (e), in any circumstance where it appears:

(1) That it would be inconsistent with a provision of the articles, bylaws, a resolution of the members or an agreement in effect at the time of the accrual of the alleged cause of action asserted in the proceeding in which the expenses were incurred or other amounts were paid, which prohibits or otherwise limits indemnification; or

(2) That it would be inconsistent with any condition expressly imposed by a court in approving a settlement.

(i) A corporation shall have power to purchase and maintain insurance on behalf of any agent of the corporation against any liability asserted against or incurred by the agent in such capacity or arising out of the agent's status as such whether or not the corporation would have the power to indemnify the agent against such liability under the provisions of this section; provided, however, that a corporation shall have no power to purchase and maintain such insurance to indemnify any agent of the corporation for a violation of Section 5233.

(j) This section does not apply to any proceeding against any trustee, investment manager or other fiduciary of an employee benefit plan in such person's capacity as such, even though such person may also be an agent as defined in subdivision (a) of the employer corporation. A corporation shall have power to indemnify such trustee, investment manager or other fiduciary to the extent permitted by subdivision (f) of Section 207.