ROGER A. BROWN
Lawyer
38 North Washington Street
Post Office Box 475
Phone (209) 533-7755 Sonora, California 95370 Fax (209) 533-7757

April 27, 2004

Fred Coleman, President
Odd Fellows Sierra Recreation Association, Inc.
Post Office Box 116
Long Barn, CA 95335

RE: Summary of Director's Fiduciary Duties

Dear Mr. Coleman:

This is to respond to your request for a summary of the fiduciary duties which are required of corporate directors and officers under California Law. I understand that the corporation is conducting an election soon and this information may be used to help orient both continuing and any new directors and officers who may be selected.

Directors Fiduciary Duty to Corporation

Directors stand in a fiduciary relationship of trust and confidence with the corporation and its shareholders. This fiduciary duty includes the duties of diligence and fidelity in performing their other duties. The duties of officers of the corporation are similar to the duties of directors and accordingly, you should assume the same rules apply to both officers and directors.

The duty of care requires the director to serve in good faith, in a manner believed to be in the best interests of the corporation and its shareholders and with such care, *including reasonable inquiry*, as an ordinarily prudent person, in a like position would use under similar circumstances. (Corporations Code §309(a).)

California courts have adopted what is called the "business judgment rule" which holds that a court will not review directors' business decisions, or hold directors liable for errors in judgment, so long as they were: 1) disinterested and independent; 2) acting in good faith; and 3) reasonably diligent in informing themselves of the facts.

A director is "disinterested and independent" within the meaning of the business judgment rule if decisions are made without self-interest or undue influence of others. Where a director has a direct or indirect interest in a decision, his or her judgment is not entitled to judicial deference and a court would likely intervene if the decision were challenged.

The business judgment rule does not excuse the lack of ordinary prudence and skill in learning the relevant and available facts. But directors may not "close their eyes" to what is going on around them. They have a duty of inquiry.

There is also a fiduciary duty of loyalty to the corporation. Loyalty means placing the corporation's and stockholders' interests ahead of any other business or personal interests. This duty is generally encountered in connection with things a director may not do. For example, a director may not directly compete with the corporation, nor divert corporate opportunities to his or her own account, nor may a director act or make corporate decisions in which he or she has a conflict of interest.

Included among a director's fiduciary duty of care and loyalty is the duty to keep the secrets of the corporation. For example, the corporation is currently involved in litigation with the owners of neighboring property. The discussions, considerations, reports and decisions made by the directors and officers in connection with that litigation should be kept confidential. The shareholders are not entitled to know about the deliberations of the board upon litigation or settlement strategy. These things are entrusted to the board of directors to decide for the benefit of the corporation and its shareholders, but shareholders do not manage the corporation and its litigation, the board does.

Similarly, communications between the board or its officers and legal counsel are entitled to the privilege of confidentiality between lawyer and client. This privilege is important to foster an open and honest dialogue between the lawyer and client that would be chilled and hampered by unauthorized disclosures. Accordingly, the attorney is powerless to waive the privilege, but the client may waive such confidentiality either intentionally or by inadvertence. Thus, it is important that all directors who have confidential information relating to litigation in which the corporation is involved to keep such information confidential. That means the information should not be shared with wives, husbands, sweethearts, associates or even with shareholders. If confidential information is shared with unauthorized persons, that act may be sufficient to constitute a waiver by the corporation of its privilege of confidentiality and open up its communications with counsel to the prying eyes of opposing counsel or others.

Conflicts of interest are to be avoided by directors. However, occasionally a situation may arise where a director cannot avoid the existence or the appearance of a conflict. In such situations, the director should first make full disclosure of the facts which constitute the interest believed to conflict with the interests of the corporation. The director holding the conflicting interest should then disqualify himself or herself from any further participation in the decision.

If the corporation makes a contract with a director or in which a director has a competing interest, the contract may be upheld only if the interest was fully disclosed to the shareholders and the contract was thereafter approved by a majority of the disinterested shares. That means the interested directors' and shareholders' votes would not be counted. The disclosure must include all material facts about the interest and the contract. If a majority of disinterested shareholders approve the decision, then it is immaterial whether the contract is fair to the corporation.

A contract or other decision in which a director has an interest may also be approved by a majority of a disinterested board, after full disclosure, but only if the contract or decision is also fair, just and reasonable to the corporation at the time it is authorized. Again, the interested director may not vote to approve the contract or decision in which he has an interest.

It is important to note that the rules summarized above are just that, a summary. The law can be complex and confusing in this area and any issues should be discussed with corporate counsel before action is taken which you believe to be questionable. Furthermore, these rules restrict the behavior of *officers and directors* but not shareholders, residents, contractors, vendors and others who do not occupy a position of trust and confidence in the corporation. Some of these same rules will apply to employees of the corporation, but that discussion is beyond the scope of this assignment.

The guiding principal behind all these rules is the duty of care, loyalty, and full disclosure to the corporation. If a director believes there is a need to inquire further, then make the inquiry. If there are unanswered questions that make a director reluctant to approve of an action, then ask the relevant questions. If a director feels pressure or competing loyalties concerning a decision, contract or issue, then he or she should disclose the facts to the other directors and discuss whether there is a conflict of interest which should cause the director to withdraw from that decision. Common sense and a good feel for what is right and wrong should help with many of these questions. If further guidance or advice is needed, then corporate counsel is always ready to assist upon request of the president or a majority of the board. However, corporate counsel represents the corporation and the board of directors as a body. Corporate counsel does not represent individual board members or officers in connection with their individual duties to the corporation and shareholders.

I hope this summary provides the guidance you seek and will assist your continuing, and any new board members and officers of the corporation, in understanding and meeting their duties to the corporation and the shareholders. Please feel free to contact me if additional information is needed.

Very truly yours,

Roger A. Brown

RAB:nab