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MEMORANDUM

To: Elizabeth K. Usher, MBA
From: Robert M. Portman, JD
Jason Z. Qu, JD
Date: June 17, 2024
Subject: Fiduciary Responsibilities of Board Members

You have asked us to comment on the general fiduciary responsibilities and other legal obligations of board members of the American Academy of Dermatology ("AAD") and the American Academy of Dermatology Association ("AADA"; collectively, AAD and AADA are referred to as "AADA"). You also asked for some tips for board members to avoid inadvertent violations of these duties.

Officers and directors of nonprofit associations (collectively referred to as "directors" or "member leaders") have certain legal obligations to the association, notwithstanding the fact that they are not compelled to serve and, in most cases, are not compensated for their services. Member leaders have a fiduciary duty to the association that includes a duty of care, a duty of loyalty, and a duty of obedience. Within these duties is a duty to avoid conflicts of interest and improper self-dealing, and to maintain the confidentiality of certain association information. Violations of these duties can lead to personal liability for the member leaders to the association, to other members of the association, or to nonmembers who are injured by the failure of officers or directors to honor their obligations.

Importantly, AAD and AADA member leaders have a separate and independent fiduciary obligation to each board on which they serve. This means that when meeting on behalf of AAD, the member leaders must act in the best interests of the Academy and when meeting on behalf of AADA, they must act in the best interests of the Association. While this may cause confusion in some cases, for the most part, the interests of the two organizations should be aligned, rather than in conflict.

Duties of Care, Loyalty, and Obedience

Duty of Care. The duty of care means that member leaders are required to exercise ordinary and reasonable care in the performance of their duties, exhibiting honesty and good faith. "Ordinary and reasonable care" means the care that a similarly situated, prudent person would exercise in similar circumstances. For instance, officers and directors must exercise due care when making statements about the association and its activities, its members, other member leaders, and staff to ensure that such statements are truthful and based on a reasonable investigation of the facts.

The duty of care includes the duty to protect confidential information pertaining to the association. The member leader's obligation is triggered if he or she knows or should know that the association considers the information to be confidential. The most obvious indication to a member leader that the association desires to maintain certain information as confidential is if the information is marked or otherwise identified as such. In addition, information transmitted in executive session of the board is presumed to be confidential. The obligation to maintain confidentiality continues indefinitely, not just until the member leader's position expires or is terminated. Board members and other member leaders should be particularly careful not to disclose confidential information from the AAD/A General Counsel or other legal counsel; as such disclosure could waive the attorney-client privilege and seriously harm the organization's legal position in litigation or other matters.

It is important to stress that the duty of confidentiality applies only to information that the association decides to treat as confidential or that is presumed to be confidential. Since associations ordinarily require a high degree of openness to ensure the goodwill of the members and to function effectively, the right to designate and maintain information as confidential should not be overused. Thus, executive sessions should only be sparingly invoked and documents should be marked as confidential only if there is a good reason to do so. On the other hand, privileged communications from legal counsel, ethics matters, and certain employment and compensation information should be treated with the utmost care and confidentiality.

The duty of care is particularly pertinent to the use of email by member leaders to discuss AAD business. Board members should exercise reasonable care not to inadvertently communicate confidential or privileged Board information to members or others in their emails and various listserv postings. Member leaders should bear in mind that, in some respects, e-mails are more permanent than paper communications and may be subject to discovery in litigation unless covered by a privilege. Unlike paper documents, it is extremely simple for an email to be forwarded to hundreds, if not thousands, of people. Accordingly, directors should take great care in how they compose and address emails relating to confidential AAD/A business to ensure they are sent only to other Board members or appropriate AAD/A staff, and do not contain any statements that could adversely affect AAD/A's business or legal interests if disclosed to third parties in the future. If possible, directors should avoid email communications involving confidential AAD/A information and using email to transmit documents that are available in secure alternative platforms such as the AAD/A online board portal. In addition, board members should only use their business email address if they own and control the computer system on which their emails reside or have received other assurances that AAD/A emails will not be subject to disclosure to their employers (e.g., such emails will be treated as personal and not subject to the employer's access.)

Member leaders should also take special care to retain confidential emails only as long as they are needed for conducting Board business and then delete them. Note that even when an e-mail message has been "erased" or "deleted," it is sometimes still possible to retrieve, read,

print, and forward the message. If member leaders have any questions about whether to send a communication by email, how long they should retain an email or set of emails, or how to ensure that an email is completely deleted, they should contact the Executive Office for advice or assistance.

The duty of care also includes the obligation to perform one's board duties in a diligent and conscientious manner. This means that board members need to prepare for and attend all board meetings if at all possible; ensure that they understand the information that is presented to them (such as financial reports); make reasonable inquiries for more information when necessary to exercise oversight over significant risks, operational issues, or legal compliance concerns; and report to leadership if there is evidence of misconduct or wrongdoing (see attached Exhibit A on such reporting obligations).

Duty of Loyalty. The duty of loyalty requires member leaders to pursue the best interests of the organization rather than their own personal or financial interests or those of some other individual or entity. The duty to act in the best interests of the association requires member leaders to act in good faith and to avoid fraud or misrepresentation. The member leader's duty of loyalty also encompasses a duty to avoid and/or disclose conflicts of interest (professional, financial, business, or personal) and to provide undivided allegiance to the association's mission. The duty to avoid conflicts of interest includes the duty to avoid expropriating corporate opportunities available to the association and to avoid unjust enrichment, including unauthorized use of the association's intellectual property, trade secrets, or proprietary ideas. The issues of what is a conflict of interest and how to best resolve them are covered in more detail in the AAD/A Administrative Regulation on Disclosure of Outside Interests and Management of Conflicts of Interest.

Duty of Obedience. The duty of obedience requires the member leader to act consistently with the organization's mission and purposes and with its articles of incorporation, bylaws, and other policies or procedures. The duty of obedience also requires member leader to ensure that the organization complies with applicable laws and regulations; this includes paying special attention to legal requirements, such as antitrust compliance, that have particular relevance or significance for nonprofit associations.

Taken together, the duties of loyalty and obedience include an obligation to accept and abide by the Board's decisions, even for directors who voted against a motion, abstained, or were absent, unless such decisions are plainly in violation of the Academy's articles or bylaws or are otherwise unlawful. Thus, when the Board takes an action, individual members of the Board should not take steps to undermine or interfere with the implementation of that decision, including making disparaging statements about the decision or the Board to other Academy members. The individual directors can move for rescission or modification of any Board action at a subsequent regular or special meeting, but as long as the Board's decision is on the books, the director should respect and comply with the decision of the majority of his or her peers.

Liability Risk

Breaches of fiduciary duty can lead to liability for the nonprofit and/or individual liability for member leaders. Nonprofit associations can be held liable for the acts or omissions of their member leaders even if they were not approved or authorized by the association as long as the member leader reasonably appears to be acting with the association's approval. For instance, public statements by an officer or director that are false and defamatory or that involve the disclosure of confidential information could lead to libel, invasion of privacy, negligence, interference with contractual relations, or other claims against the association and the individual officers or board members involved in such a transgression. Likewise, failure to disclose conflicts of interest and other breaches of fiduciary duties could lead to damage to the association for which the responsible member leader could be held responsible.

We do not mean to overstate the risk of serving as an AAD/A officer or board member. Personal liability risks are reduced by the so-called "business judgment rule." Under this rule, directors are presumed to have acted in good faith and generally will not be held liable for mere errors in judgment or simple negligence. Typically, a showing of bad faith, dishonesty, reckless disregard, or gross negligence is required to impose personal liability. Directors may also rely on outside experts in making decisions on behalf of the association as long as such reliance is reasonable and extended in good faith.

Congress passed the Volunteer Protection Act to protect volunteer members for nonprofit organizations from liability for their acts or omissions on behalf of the organization if: 1) the member was acting within the scope of the member's responsibilities in the nonprofit organization at the time of the act or omission, 2) the harm was not caused by willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious, flagrant indifference to the rights or safety of the individual harmed by the member; and 3) the member was not compensated for his or her time as a volunteer for the organization.

Directors and officers who act in good faith are also covered under the AAD/A's liability insurance policy. However, that policy does not cover conduct that is fraudulent or dishonest. Similarly, the AAD and AADA bylaws permit indemnification of directors and officers to the fullest extent of the law. Under Minnesota law, this means that AAD and AADA are generally required to indemnify their officers and directors for actions taken in their official capacity unless the individual acted in bad faith or did not reasonably believe the conduct in question was in the best interests of the organization.

Tips for Minimizing Risk

AAD/A officers and directors can minimize the risk of breaching their fiduciary obligations to the organization by:

- Placing the association's interests first in dealings on the association's behalf.
- Reviewing the association's articles, bylaws, rules, policies, and regulations.
- Attending all board meetings (including orientation sessions) and carefully reviewing briefing materials and minutes provided in advance of or between meetings.
- Ensuring that statements made about AAD/A activities, members, other member leaders, or staff are truthful and based on a reasonable investigation of the facts.
- Being alert to possible conflicts of interest and circumstances that could create even the appearance of a conflict and by scrupulously disclosing and resolving conflicts in the best interests of AAD and AADA.
- Carefully preserving the confidentiality of any information that comes into the member leader's possession that the member knows or should know is designated or treated as confidential by AAD or AADA.
- Being careful about sending emails that discuss confidential board information and ensuring that such emails are retained only for so long as necessary.
- Exercising due diligence in making decisions generally, examining financial reports, and reviewing all major transactions to ensure they are carried out on an arms-length basis at fair market value to the organizations, and that the fair market value is documented through comparability analyses, independent appraisals, or the like.
- Reviewing the organizations' directors and officers and general liability insurance to ensure appropriate coverage (and exclusions) for the type of activities that typically confront the officers and directors.

We hope this information is helpful. Please let us know if you have any questions or would like to discuss this matter further.

EXHIBIT A:

**Duty to Report Information Related to Misconduct, Wrongdoing, or Significant Risks
("Duty to Inform")**

Board members have fiduciary duties of care, loyalty, and obedience to AAD/A under common law and applicable nonprofit codes. One obligation relevant to all three fiduciary duties is a duty to proactively "report up" to Academy leadership information that AAD/A directors or officers become aware which could materially impact the legal or business interests of the Academy. This obligation applies whether the member leader learns this information through their Academy leadership role(s) or while acting in any other capacity. This obligation is sometimes called a "duty to inform."

Reporting this type of information helps to mitigate risks and potential liability to the Academy, can support legal compliance, and keeps the information from being potentially (or actually) misused or misappropriated. Some illustrative categories of reportable information include: (1) observed or suspected wrongful acts or misconduct; (2) significant issues or concerns communicated to member leaders by members; or (3) other information indicating potential legal or operational risks to the Academy. If member leaders are unsure whether information is significant enough to report, or whether the information is already known to Academy leadership, they should err on the side of reporting the information to Academy leadership.

It is critical that this information is reported to Academy leadership through the proper reporting channels. Doing so helps to ensure that the information is received and acted upon appropriately; it also prevents information from being further disseminated or used, especially by unauthorized individuals. Member leaders should be mindful that limiting the disclosure of confidential, sensitive, or potentially harmful information is also an element of their fiduciary duties to the Academy.

Therefore, member leaders should always report concerning information to appropriate senior leadership staff and/or officers, depending on the nature of the information and the issues involved, and refrain from further discussing or disclosing the information to members, other Academy staff, other member leaders, or members of the general public. If they are unsure of who information should be reported to, member leaders may consult with Elizabeth Usher, Sarah Tancredi, or Cyndi Del Boccio in all cases where those individuals do not have a conflicting interest in receiving and managing the report.