

PT-A – 65

Donor comments:

Intro was way too long. 1/2 page is more than enough and this was over 3pgs with statement of facts and other things not asked for. 30% of the answer here... and it doesn't count for anything.

Section 2 was weak.

1)

To: Sonia Sanches

From: Applicant

Date: July 30, 2013

Re: In re SIA

I. Facts and Procedural History

Karen Barber ("Barber") is the new Executive Director of Sensory Integration Alliance, Inc. ("SIA"). She took up the position after the death of the previous Executive Director, Vernon Ellis ("Ellis") on or around July 15, 2013. SIA is in the business of sponsoring seminars and classes on sensory integration several times a year. The corporation is filed as a non-profit created to collect and disseminate information to enable individuals to understand their sensory disabilities. SIA also maintains a database of medical and educational specialists with which it can make referrals for individuals who need services for their sensory disabilities.

Each seminar or class has a separate file containing spreadsheets showing the names and contact information for each person signed up and recording each person's advanced payment. It was the common practice of Ellis to, upon cancellation, inform the participant of the cancellation and ask if they wanted their money refunded or if they would like to donate their payment to SIA as a charitable organization. Upon investigation, Barker discovered that the refund checks to participants who requested them were being deposited at Balfour Bank into an account in Ellis's name.

Upon further investigation by Barber it seemed that the seminars were non-existent. Upon moving into Ellis's office, Barber discovered locked drawers and had a locksmith open them. Inside were records for the Balfour Bank account in Ellis's name. Ellis would write a check in the proper amount payable to the

participant requesting a refund, then endorse the check with that person's name on the back in what Barber recognizes as Ellis's handwriting, and deposit the check into his account at Balfour Bank. Ellis would periodically write checks from this account to his sister, Adele Stevens ("Stevens").

Over three years this process occurred with approximately \$18,000 in refund checks.

Also in Ellis's drawer were invoices for a company called Klene Up Kroo for janitorial services and checks written to that company for the amounts of the invoices. Over 18 months, this came to a total of \$22,000 that were drawn from SIA's account by Ellis. Those checks were endorsed by Howard Klene and deposited into an account in Howard Klene's name at First Bank. Regular deposits were drawn from Klene's account and deposited into an account in Ellis's name at Arden Bank. Disbursements from Arden Bank were regularly made to Ellis and Alan Zackler ("Zackler")

Ellis's desk also contained a drawer of 990s which were Form 990s required to be filed annually with the IRS and Attorney General which informs of major donors, members of the board, compensation paid to the board and staff, and operational expenses. The forms, which seemed original, for 2010, 2011, and 2012 were all present accompanied by memos from Ellis to the board that they had been timely filed. Letters from the IRS were also present indicating that the 990s for 2010 and 2011 had never been recieved with a handwritten note across the top from AZ asking Ellis to handle it. Upon inspection of the 990s by Barber, several major donors seemed to be missing and the operational expenses seemed to be overstated by quite a bit.

One folder in the drawer labeled "Expense Accounts - Vernon/2011" in Ellis's handwriting. It seemed, upon investigation by Barber that Vernon had been writing checks from SIA's account to pay for dinner parties, but then submitting

receipts for personal reimbursement. Ellis would do the same with his SIA credit card, paying the bill with an SIA check and seeking personal reimbursement. This totaled about \$12,500; only \$4,000 of which was supported by back-up receipts. Procedure calls for the expenses to be approved by the board, and about once per quarter Ellis would attend to present his expenses at which point Zacker would assure the board of their accuracy and move that they be accepted. The September 5, 2011, April 15 2012, and Jan 15, 2013 all show instances where expenses were questioned, but Zacker assured the board that all expenses were legitimate.

Futher, there is a \$70,000 check to Wanderly Travel Service, owned by Melanie Wanderly ("Wanderly") who is also a board member if SIA. The invoice was for a Carribean cruise for Wanderly, Zackler, Ellis and their spouses for 10 days, but no records indicate that the trip was business related at all, even though it was described as a trip for "long range planning." It was also manifested as "accumulated organizational expenses" in the financials.

SIA is currently in good financial health with a steady stream of incoming charitable donations, foundational grants on track for renewal, and \$500,000 in reserves.

Wanderly and Zackler are about to step down from the board, and none of this information has been disclosed to the board.

On July, 15, 2013, Barber received a letter from the Attorney General's office enclosing a complaint from a person who claims that she had sent in a check to cover the cost of her attendance at a series of classes that SIA was sponsoring. Barber was notified that she had 30 days to respond from July 15, 2013. The complaint from Alice Rayburn ("Rayburn") and was about \$895 dollars paid for in advance when the seminar was canceled. No refund was provided to Rayburn. Rayburn called Ellis at last four times and Ellis assured her that she would be

reimbursed, but she never was.

II. Issues

Will SIA face liability for the bad acts of its former leadership? Namely, canceled or unscheduled seminars, payments for Klene Up Kroo janitorial services, unfiled form 990s, expense account reimbursements to Vernon Ellis, and a cruise taken by board members. Finally will the Attorney General successfully be able to seek dissolution of the corporation?

II.A Potential Remedies and Sources of Law

1. SIA Will Be Liable for Canceled or unscheduled seminars when the Seminars Never Existed and Participants were Never Reimbursed.

A corporation is subject at all times to examination by the Attorney General, on behalf of the State, to ascertain the condition of its affairs and to what extent, if at all, it fails to comply with trusts which it has assumed, or has departed from the purposes for which it is formed. Columbia Corporations Code, Nonprofit Corporation Law § 5250 ("§5250"). In case of any such failure or departure, the Attorney General may institute, in the name of the State, the proceeding necessary to correct the noncompliance or departure. §5250. The Attorney General can bring this action upon his own information, or upon the information of a private party and may procure a judgment dissolving the corporation and annulling, vacating or forfeiting its corporate existence if (1) the corporation seriously offended against any provision of the statutes regulating corporations or charitable organizations (2) the corporation has fraudulently abused or usurped corporate privileges or powers or (3) the corporation has violated any provision of law by act or default which under the law is a ground for forfeiture of corporate existence. §6511. If the Attorney General will give at least 30 days notice prior to institution of suit, and the matter has not been corrected within that

period, the Attorney General may maintain the suit. §6511. The court may, in any such action, order restitutionary and/or injunctive relief to compensate or protect members of the public who have been harmed by the corporation's violations of the law. §6511. The court may order dissolution or such other or partial relief as it deems just and expedient, or may appoint a receiver for winding up the affairs of the corporation, or that the corporation be wound up by its board under court supervision.

Here, each seminar or class has held by SIA had separate file containing spreadsheets showing the names and contact information for each person signed up and recording each person's advanced payment. It was the the common practice of Ellis to, upon cancellation, inform the participant of the cancellation and ask if they wanted their money refunded or if they would like to donate their payment to SIA as a charitable organization. Upon investigation, Barker discovered that the refund checks to participants who requested them were being deposited at Balfour Bank into an account in Ellis's name. Upon further investigation by Barber it seemed that the seminars were non-existent. Upon moving into Ellis's office, Barber discovered locked drawers and had a locksmith open them. Inside were records for the Balfour Bank account in Ellis's name. Ellis would write a check in the proper amount payable to the participant requesting a refund, then endorse the check with that person's name on the back in what Barber recognizes as Ellis's handwriting, and deposit the check into his account at Balfour Bank. Ellis would periodically write checks from this account to his sister, Adele Stevens ("Stevens"). On July, 15, 2013, Barber received a letter from the Attorney General's office enclosing a complaint from a person who claims that she had sent in a check to cover the cost of her attendance at a series of classes that SIA was sponsoring. Barber was notified that she had 30 days to respond from July 15, 2013.

An action by the Attorney General would be supported under § 5250 and §6511 because SIA, via Ellis, has fraudulently procured funds of the public at large for

non-charitable use. Such a procurement certainly runs contrary to the purpose of a non-profit organization and the Attorney General is entitled to pursue action to dissolve the corporation or remedy the harm done in accordance with §6511. If the harm can be remedied, it seems that a court is not likely to dissolve the corporation if 1) all of the wrongdoers involved are no longer with the corporation 2) those left in the corporation are not guilty of wrongdoing, 3) the company is operating well after the poor conduct. *Attorney General v. Sidley Memorial Hospital*. In *Sidley*, the court decided that dissolution was harsh upon satisfaction of the above factors and that a monitor should be appointed to ensure that the corporation clean up its act.

While the Attorney General has broad power under common law and the Uniform Act §127 to carry out charitable trusts and enforcement responsibilities, the court may not be as quick to dissolve a corporation where the wrongdoing was isolated to board members no longer present. A court will likely appoint a supervisor for SIA affairs and order SIA to reimburse those whose money was wrongfully taken.

2. SIA Will Not Be Liable for Payments for Klene Up Kroo janitorial services when Ellis was Siphoning Funds from SIA to HIs and Zackler's Personal Accounts

Here, all of the wrongdoing involved with Klene Up Kroo involved Ellis siphoning SIA funds to himself and Zackler. No money was taken from the public at large, so SIA will not be responsible to cure that harm. In Ellis's drawer were invoices for a company called Klene Up Kro for janitorial services and checks written to that company for the amounts of the invoices. Over 18 months, this came to a total of \$22,000 that were drawn from SIA's account by Ellis. Those checks were endorsed by Howard Klene and deposited into an account in Howard Klene's name at First Bank. Regular deposits were drawn from Klene's account and deposited into an account in Ellis's name at Arden Bank. Disbursements from

Arden Bank were regularly made to Ellis and Alan Zackler. SIA will not bear liability.

3. SIA Will Be Liable for Unfiled Form 990s to the Attorney General; Likely in the Form of Suspension of Non-Profit Status and Injunction Against Fundraising Activities

Potential Remedy and Source of Rule

Annually, every charitable corporation must file with the Attorney General a copy of the Form 990 submitted to the IRS. The Uniform Act § 125. Upon registration, a corporation shall file the first Form 990 no later than four months and 15 days following the close of the first calendar year in which property is initially received. The Uniform Act § 125. The Attorney General may refuse to register or may revoke or suspend the registration of a charitable corporation or trustee or commercial fundraiser whenever the Attorney General finds that the charitable corporation or trustee or commercial fundraiser has violated or is operating in violation of any provisions of this Act. The Uniform Act § 127(b). If such a corporation that fails to comply with financial reporting requirements, "the Attorney General may obtain restitutionary relief, injunctive relief, and the remedies are cumulative to those available under the provisions of the law. Corporations Code §6511." *People v. Orange County Charitable Services ("OCCS")*.

Analysis

Here, Ellis's desk also contained a drawer of 990s which were Form 990s required to be filed annually with the IRS and Attorney General which informs of major donors, members of the board, compensation paid to the board and staff, and operational expenses. The forms, which seemed original, for 2010, 2011, and 2012 were all present accompanied by memos from Ellis to the board that they had been timely filed. Letters from the IRS were also present indicating that the 990s for 2010 and 2011 had never been received with a handwritten note

across the top from AZ asking Ellis to handle it. Upon inspection of the 990s by Barber, several major donors seemed to be missing and the operational expenses seemed to be overstated by quite a bit.

Because of the failure to comply with financial regulations, the Attorney General is within his right to pursue action and may obtain the retentive or injunctive action or even dissolution of the corporation. As stated in part 2 above, the court may find that dissolution is harsh here because the responsible wrongdoers are on their way out of the company. If that is the case, there is likely to be a judgment of injunction against further solicitation of donations and possible suspension of non-profit status until a supervisor appointed by the court verifies that the company has "cleaned up its act."

4. SIA Will Not Be Liable for Expense Account Reimbursements to Vernon Ellis when Ellis Practice Regular Diverting of SIA Funds to his Personal Accounts with the Assistance of Cover-Up Practices from Zackler Unless the Attorney General deems the Act So Contrary to Non-Profit Activity that the Non-Profit License is Suspended

Potential Remedy and Source of Rule

The Attorney General has broad powers under common law and Columbia statutory law to carry out these charitable trust enforcement responsibilities. The Uniform Act § 127(a). These powers include, but are not limited to, charitable trust enforcement actions under all of the following: This Act; The Nonprofit Corporation Law, Corporations Code Sections 5000, et. seq. The Uniform Act § 127(a). The Attorney General may refuse to register or may revoke or suspend the registration of a charitable corporation or trustee or commercial fundraiser whenever the Attorney General finds that the charitable corporation or trustee or commercial fundraiser has violated or is operating in violation of any provisions of this Act. The Uniform Code § 127(b). The function of equity is not to punish, but merely to take such action as may be necessary to prevent the recurrence of

improper conduct. Sidley. Where voluntary action has been taken in good faith to minimize such recurrence, this is a factor which the court can take into account in formulating relief. Sidley.

Analysis

One folder in the drawer labeled "Expense Accounts - Vernon/2011" in Ellis's handwriting. It seemed, upon investigation by Barber that Vernon had been writing checks from SIA's account to pay for dinner parties, but then submitting receipts for personal reimbursement. Ellis would do the same with his SIA credit card, paying the bill with an SIA check and seeking personal reimbursement. This totaled about \$12,500; only \$4,000 of which was supported by back-up receipts. Procedure calls for the expenses to be approved by the board, and about once per quarter Ellis would attend to present his expenses at which point Zacker would assure the board of their accuracy and move that they be accepted. The September 5, 2011, April 15 2012, and Jan 15, 2013 all show instances where expenses were questioned, but Zacker assured the board that all expenses were legitimate.

Here there is no harm to the public in general, however the corporation has been operating in violation of the Uniform Code. If the company can make "a clean and final break between past and future" it may be able to persuade the court that it need not be dissolved. Sidley. Barker has taken on efforts to investigate all of the wrongdoing and is working to comply with the Attorney General to remedy the situation. This, considered along with the fact that the wrongdoers are departing the corporation and new incoming board members have not been implicated in any foul play, should weigh in favor of SIA. The court will likely appoint a supervisor while SIA straightens out its affairs as opposed to dissolving the corporation; but no monetary liability is owed.

5. SIA Will Not Be Liable for Cruise Taken by Board Members for Seemingly Recreational Purposes Unless the Attorney General deems the Act So Contrary

to Non-Profit Activity that the Non-Profit License is Suspended

There is a \$70,000 check to Wanderly Travel Service, owned by Melanie Wanderly ("Wanderly") who is also a board member of SIA. The invoice was for a Caribbean cruise for Wanderly, Zackler, Ellis and their spouses for 10 days, but no records indicate that the trip was business related at all, even though it was described as a trip for "long range planning." It was also manifested as "accumulated organizational expenses" in the financials.

Although this appears to be self-dealing, the directors responsible, not SIA will be liable. Corporations Code §5233. SIA will be liable to the Attorney General's action to the same extent as it was in Part 4 above and would follow the same analysis. SIA will not have liability for any breach of duties of loyalty or care by its departing directors.

II.B The Attorney General May successfully seek a suspension of non-profit status

As discussed above in conjunction with each of the bad acts, the Attorney General is entitled to seek restitution, injunction or even dissolution. Uniform Act § 127; Corporations Code §6511; OCSS. The Columbia Supreme Court, in *Sidley*, has recognized that when the wrongdoing in a non-profit corporation is primarily engaged in by selected members, the corporation may be able to make a "clean and final break between the past and the future" in order to save itself from dissolution. The function of equity is not to punish, but merely to take such action as may be necessary to prevent the recurrence of improper conduct. *Sidley*. Where voluntary action has been taken in good faith to minimize such recurrence, this is a factor which the court can take into account in formulating relief. *Sidley*.

Here, Barker has come forward two weeks after assuming her leadership

position at SIA to investigate what she sees as suspicious past activity. She has isolated the suspect activity to a select few individuals and has indicated that those members are soon departing the company. She is working to comply with the Attorney General's request for an explanation pursuant to the filed complaint by a private party. None of the incoming board members are suspected in any of the wrongdoing and the company is still financial stable with reserves of \$500,000. Taking all of these factors into consideration, it is likely that a court will not pursue dissolution, but will allow the appointment of a supervisor for SIA to operate while it straightens out its affairs. It may receive a suspension of its non-profit status during that time in accordance with the Attorney General's power under the Uniform Act, and be enjoined from conducting fundraising activities.