1)

Memorandum Regarding Sensory Integration Alliance, Inc.'s ("SIA") Potential Liability Resulting From Alleged Failure to Refund Fees for Unpaid Seminars

This memorandum has been prepared for the purpose of providing SIA and its new Executive Director, Ms. Karen Barber, with appropriate recommendations regarding SIA's response to the Attorney General's letter dated July 15, 2013 regarding a consumer complaint filed as a result of SIA's alleged failure to refund fees for canceled seminars. To summarize the crucial parties, Ms. Barber has replaced SIA's former Executive Director, Vernon Ellis. SIA's Chair of Board's Budget and Finance Committee is Alan Zackler. The following analysis is based on the facts that have been disclosed to Sanchez & Martin as well as all applicable case and statutory law.

(II) Potential Remedies the Attorney General May Seek With Respect to Certain Acts and/or Omissions by SIA

1. Canceled or Unscheduled Seminars

Based on Ms. Barber's interview, we have learned that SIA sponsors seminars and classes on sensory integration several times a year. On occassion, a class will get canceled. Based on what appears to be the applicable practice when Ellis was the Executive Director, a cancelled seminar would result in Ellis sending out eltters to those who had paid, telling them of the cancellation, and asking whether they wanted a refund or whether they would agree to donate their payment to SIA as a charitable contribution. Internal investigation revealed that all checks purportedly made out to those parties to be refunded were, in fact, deposited at Balfour Bank in an account in Ellis' own name. Furthermore, Ms. Barber has informed us that some cancelled seminars reveal no evidence that anything had ever been done to arrange for these events in the first place.

(A) Potential Remedies

In order to reimburse all parties who had paid fees to attend seminars and/or classes sponsored by SIA, the AG may seek any type of action that will refund all parties. In the event that SIA's immediate assets are insufficient, such action may include the dissolution of SIA.

(B) Applicable Statutory Law Proscribing the Remedy

Columbia Corporations Code Section 5250 states in relevant part:
A corporation is subject at all times to examination by the AG...to ascertain certain conditions 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. In case of any failure or such departure, the AG may institute the proceeding necessary to correct the noncompliance or departure.

Columbia Corporations Code SectionSection 6511 states in relevant part:
The AG may bring an action against any corporation upon the AG's own informatino or upon complaint of a private party to procure a judgment dissolving the corporation and annulling, vacating or forefiting its corporate existence on the grounds of the corporation (1) seriously offending against any provision of the statutes regulation corporations or charitable organizations; (2) fradulently abusing or usurping corporat privileges; (3) violating any provision of law by any act or by default which is ground for forfeiture of corporate existence.

Additionally, Section 6511(c) also provides that in such an action, the court may 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. THe court may order dissolution or other partial relief as it deems just and expedient.

Columbia Corporations Code Section 5223 states in relevant part:
If a self-dealing transaction has taken place, the interested director or directors shall do all things and pay such damages as in the discretion of the court will

provide an equitable and fair remedy to the corporation and may order the director to account for any profits made from such transaction.

(C) Determining Whether the Facts Support a Basis for the Attorney General to Impose the Remedy

Here, the complaint to the AG, filed January 30, 2013 by Alice Rayburn indicates that Ms. Rayburn claims to have had "at least four calls with Vernon Ellis" who assured her that "the funds were being refunded." However, she has never received this refund. In addition to the facts uncovered by Ms. Barber during her internal investigation, the facts tend to support any action by the AG to seek a refund of cancelled semianars to the affected parties regardless of whether they were ever in existence. Furthermore, Ellis' actions indictate that there are other parites similar to Ms. Rayburn who have been affected. However, if SIA can show that Ellis acted as an interested director pursuant to Columbia Corporate Code Section 5233, the AG may file action against Ellis and his estate and seek reimbursement of damages owed to SIA. SIA may then subsequently reimburse the proper parties.

Ellis Acted as an "Interested Director"

Code Section 5233 states in relevant part that "if a self-dealing transaction has taken place, the interested director or directors shall do all things and pay such damages as in the discretion of the court will provide an equitable and fair remedy to the corporation" and may order the director to account for any profits made from such transaction.

Therefore, in order to determine the scope of any potential financial impact to SIA, it is imperative that Ms. Barber makes a determination of the amount owed to all parties who had paid for any SIA sponsored seminar and were failed to be reimbursed by Ellis on behalf of SIA. Such an amount may have also have the additionl impact on the AG and/or the court's determination of whether

dissolution of the company is an appropriate action to take.

2. Payments for Klene Up Kroo Janitorial Services

A series of invoices were discovered, paid to the Klene Up Kroo (KUK) for janitoral services and such checks totalled over $22,000 over 18 months. These checks were drawn on SIA's account and signed by Ellis. These checks were endorsed in the name of Howard Klene and deposited into an account in Howard Klene's name at First Bank. Then, regular withdrawals were made from this account and subsequently deposited into an account opened in Ellis' name at Arden Bank. Disbursements from Arden Bank were made regularly to Ellis and Zackler from this account; each received $8,000.

(A) Potential Remedies

Similar to the previous discussion, Ellis, as well as Zackler, may be pursued by the AG to be found personally liable for the damages suffered by SIA in the amount of approximately $8,000 each, or as the proper accounting of the pilfered funds will determine.

(B) Applicable Statutory Law Proscribing the Remedy

Columbia Corporations Code Section 5250 states in relevant part:
A corporation is subject at all times to examination by the AG...to ascertain certain conditions 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. In case of any failure or such departure, the AG may institute the proceeding necessary to correct the noncompliance or departure.

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statutes regulation corporations or charitable organizations; (2) fradulently abusing or usurping corporat privileges; (3) violating any provision of law by any act or by default which is ground for forfeiture of corporate existence.

Additionally, Section 6511(c) also provides that in such an action, the court may 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. THe court may order dissolution or other partial relief as it deems just and expedient.

Columbia Corporations Code Section 5223 states in relevant part:
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(C) Determining Whether the Facts Support a Basis for the Attorney General to Impose the Remedy

As previously discussed, the facts support a showing that Ellis and Zackler were fradulently obtaining funds through a ficitious name. These funds were directly siphoned from SIA's account. However, an accounting will need to be performed to determine whether Ellis and/or Zackler received more than $8,000 and/or whether additional parties were involved, so as to account for the remaining $6,000 paid to KUK.

3. Unfiled Form 990s

Form 990s, completely filled out and signed by Zackler for the years 2010, 2011, 2012 were discovered by Ms. Barber. Further, memos to the Board from Ellis dated the last 2 years, stated that the 990 forms for 2010, 2011, 2012 were timely filed. In addition, a letter from the IRS to Zackler dated April 20, 2012 stated that the 990 forms for 2010 and 2011 had never been received by the IRS.

(A) Potential Remedies

SIA can move to file the late form 990s immediately and ensure that its current form 990 is up to date. However, as will be discussed, the Columbia Corporations Code's treatment of late filings appears to be monetary fines. There does not appear to be any other alternative remedies available to SIA.

(B) Applicable Statutory Law Proscribing the Remedy

Section 125 requires that every charitable corporation must file a copy of the Form 990 with the AG and submit it to the IRS. The timing for such filing is not later than 4 months and 15 days following the close of the first calaneder or fiscal year in which property is initally received. A charitable corporation may be asseed an additional late fee of $25 per month for each month or part of the month it fails to file its first and subsequent Form 990s.

(C) Determining Whether the Facts Support a Basis for the Attorney General to Impose the Remedy

Here, the facts indicate that Form 990s had not been filed for at least 2010 and 2011. It is unclear whether SIA paid its registration fee as a charitable corporation. Therefore, if it failed to do so, the AG may seek payment of that registration fee in addition to $25 per month for a total of at least 24 months and each additional month that SIA's Form 990 is overdue.

4. Expenses Account Reimbursements to Vernon Ellis

Expense vouchers in Ellis' handwriting had receipts, but most did not have any supporting or "back up" documents attached. Such entries were related to SIA travel and entertainment, e.g. dinner parties, cocktail parties. Ellis would use an SIA credit card, pay the credit card bill with an SIA check, and seek personal reimbursement for these expenses. The reimbursement total to Ellis was $12,500, but only $4,000 was supported by back-up receipts. Ms. Barber informed us that the procedure for verifying and approving expense

reimbursements of the Executive Director was for the Executive Director to submit it to the Board of Directors.

(A) Potential Remedies

The AG can seek reimbursement of expenses to SIA and find Ellis (his estate) personally liable for the unaccounted/unsupported reimbursements.

(B) Applicable Statutory Law Proscribing the Remedy

Code Section 5233 states in relevant part that "if a self-dealing transaction has taken place, the interested director or directors shall do all things and pay such damages as in the discretion of the court will provide an equitable and fair remedy to the corporation" and may order the director to account for any profits made from such transaction.

(C) Determining Whether the Facts Support a Basis for the Attorney General to Impose the Remedy

However, it appears that the AG may not have sufficient information to support a pursuit of this claim because as Section 5233 indicates, if the corporation's board authorized or approved the transaction in a good faith vote by a majority of directors, then the AG shall not pursue any remedies nor shall the court grant them if these facts are established. Given the facts that we have been provided, the only procedure for verifying and approving reimbursement expenses was for Ellis to submit them to the Board of Directors. Moreover, based on the Minute Meetings, the Board did in fact approve of these reimbursement expenses, albeit after assurances by Zackler that they were valid. Unless Ms. Barber can provide us with additional information to indicate otherwise, SIA will not be able to recover any potential lost funds as a result of personal account reimbursements to Ellis.

5. Cruise Taken By Board Members

In her investigation, Ms. Barber discover a $70,000 check made to Wanderly

Travel Service, a company owned by Melanie Wanderly who is also a Board member. The check traced back to an invoice for a Carribean cruise for the Executive Committee of the Board, comrpised of Zackler and Wanderly, as well as Ellis, who is an ex officio member of the board given his title as Executive Director. All three parties, along with their respective spouses, attended this 10 day cruise. While the agenda described it as long range planning for the committee, there is no other evidence to indicate that no official business was conducted for a substantial protion of the trip. However, the expenditure showed up on the financial statement as an "accumulated organizational expense" and there is no discussino o fthis item during Zackler's presentation of his financial report.

(A) Potential Remedies

As we have been informed, action has already been taken against any potential director who may be personally liable for a breach of his or her fiduciary duty owed to SIA.

(B) Applicable Statutory Law Proscribing the Remedy

Code Section 5233 states in relevant part that "if a self-dealing transaction has taken place, the interested director or directors shall do all things and pay such damages as in the discretion of the court will provide an equitable and fair remedy to the corporation" and may order the director to account for any profits made from such transaction.

(C) Determining Whether the Facts Support a Basis for the Attorney General to Impose the Remedy

As "interested directors" Wanderly, Zackler, and Ellis may be personally liable if there is substnatial evidence that the Carribean cruise was for the purpose of pleasure and not business. However, absent additional facts, it is unclear if the AG can pursue action against Wanderly, Zackler, and Ellis to compel them to reimburse their proportional share of the $70,000 to SIA. I recommend that we

immdiately follow up with Ms. Barber to determine whether she can provide us with new information regarding the extent that SIA-related business activities were conducted during this 10 day period.

(II) Can the AG Successfully Seek a Receivership or Dissolution of SIA?

Ms. Barber has informed us that the AG has given SIA written notice and a 30-day period to respond to its notice. Time is certainly of the essence here, and based on the applicable statutes, it appears that SIA may avoid dissolution or a receivership if certain action is taken immediately. Although the court ultimately has considerable discretion in determining whether a corporation is subject to dissolution or other relief, well-established case law is in favor of relief under equity that recommends alternatives other than dissolution. (Attorney General v. Sidley Memorial Hospital, 1994).

Applicable Statutory Law Gives the Court Discretion in Effectuating Any Equitable Remedy

Section 5250 states in relevant part:
A corporation is subject at all times to examination by the AG...to ascertain certain conditions 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. In case of any failure or such departure, the AG may institute the proceeding necessary to correct the noncompliance or departure.

Section 6511 states in relevant part:
The AG may bring an action against any corporation upon the AG's own information or upon complaint of a private party to procure a judgment dissolving the corporation and annulling, vacating or forefiting its corporate existence. However "such suit shall not be maintained if the ground of the action is a matter or act which the corporation has done or comitted to do that can be corrected by

amendment of its articles or by other corporate action." If the corporation has failed to institute proceedings to correct such matters within the 30 day period or thereafter fails to duly and properly make such amendment or take corrective corporate action, the AG may resume actions leading up to dissolution of the corporation.

1. SIA Is Not a Sole Proprietorship and There is No Substantial Evidence of Wrongdoing on Other Board of Director Members

In the People v. Orange County Charitable Services (1998), the Court held that Orange County Charitable Services (OCCS) was unlawfully conducting their business to raise money for charitable purposes. In support of their findings, the Court noted that OCCS failed to keep separate accounts of charitable funds and used them for other purposes. OCCS entered into more than 100 subcontracts with various parties to conduct commercial fundraising, dividing the 90 percent fee resulting from the gross revenues, while paying less than 10% of the gross revenues to charitable organizations OCCS had purportedly dedicated itself to.

With respect to SIA, OCCS is inapplicable for several reasons. First, OCCS was established as a sole proprietership where Mitchell Doyle was the sole director to the proprietership. There were no Board of Directors present, no other feasible method of safeguarding against poor financial jugdment. As the Court established, Doyle had no oversight because there was no potential for any to begin with. SIA, on the other hand, maintained a full Board of Directors with Zackler at the helm of the Finance Committee. Second, there is no indication that any of SIA's directors aside from Ellis and Zackler gained any profit as a result of SIA's gross revenue. Third, unlike OCCS, SIA has never used telemarketers or mass mailers to garner fundraising. Finally, while Ellis previously represented to some parties that they could elect to "donate" their seminar deposit as a donation, there are no facts to suggest that there is any misrepresentation on part of any current Board of Director or any other director at the time any of these wrongdoings were alleged to have taken place. This is

also unlike OCCS, where the Court found witnesses that explicitly testified about specific instances of misrepreseentations, such as telephone solicitations identifying themselves as being from the charities instead of disclosing his or her commerical fundraising status. Again, SIA is not a commercial fundraiser and there have been no indication to suggest otherwise.

(a) To Strengthen Its Position, SIA Should Amend its 501(c)(3) Filing

However, while SIA has been established as a 501(c)(3) nonprofit corporation, the OCCS Court reiterated that the purpose of a nonprofit under Section 501(c)(3) is solely for charitable purposes and that no benefit can be inured to any director, officer, or member or to the benefit of any private person. Although SIA's nonprofit filings are not illegal per se, they certainly are more suspect given the events that have transpired. Therefore, not only should Ms. Barber disclose the events that have occurred regarding the acts of Ellis and Zackler, the Board should seek to amend its filings to narrow the scope of its charitable work. Based on SIA's current filings, the AG may conclude that although the charitable purpose is to provide services to those with sensory disabilities via information on treatment and referrals along with seminars, SIA will need to supplement, if not modify in its entirety, its filings to conclusively show that its funds are being used for specific purposes.

2. Dissolution is Not Necessary if SIA Can Show That: (i) SIA's Budgetary Decisions Were Dominated By Ellis and Zackler; (ii) SIA Has Taken Remedial Measures in Good Faith; and (iii) There Was No Indicating that Any Other Directors Were Involved in Fradulent Practices

Although the court retains the discretion to effectuate any remedy it deemes expedient and just, case law has held that dissolution is not the only remedial measure available in light of a corporation's good faith efforts to prevent future misconduct and in light of proof that the corporation's board of directors were

dominated by select parties. In Sidley, the Board was dominated by Mr. Ormen and Mr. Ernst who were found to be "continuously involved" in the charity's affairs. As the Court stated, the management decisions, including budgetary and investment decisions, received "cursory supervision from the Executive Committee and the full Board." This is analogous to the issues concerning SIA and the director roles of Ellis and Zackler. As evidenced by the Meeting Minutes below, not only did Ellis and Zackler's acts receive cursory supervision from the rest of the full Board, but all other directors had no identifiable supervisory role over any SIA financial policy at large.

(a) SIA's Budgetary Decisions Were Dominated by Ellis and Zackler

With respect to the dominance of Ellis and Zackler, the signs of "cursory supervision" from the full Board is unambiguously evidenced in the following Board of Directors meeting minutes, as summarized briefly below:

- **SIA Board of Directors Meeting Minutes dated September 15, 2011:** Directors Jeff Garcia and Warrick Dunne questioned certain expenditures. However, Zackler responded that he had reviewed each of them and that each was bona fide. Board also discussed the status of SIA's public seminars, yet Ellis reported that the programs were on track and had been well received.

- **SIA Board of Directors Meeting Minutes dated April 15, 2012:** Director Warrick Dunne led a discussion by several directors about the apparent increase in staff travel reimbursements. Zackler assured that these were legitimate expenses associated with the increase in public seminar programs. Additionally, Zackler assured the Board that all of the expenditures had been reviewed and were well-documented in SIA files.

- **SIA Board of Directors Meeting Minutes dated January 15, 2013:** Zackler reported that preparation of the annual budget had been delayed because all of the previous year's income and expense data were not ready and that Ellis "was still working on it." Several directors expressed serious concern, yet Zackler reassured them that everything was in order. In addition, Director Garcia asked if SIA's reports to the IRS and State Franchise Tax Board had been filed, Zackler assured the Board that all reporting requirements had been met.

Similar to the facts in Sidler, SIA's Board of Directors did not realize that the status of the charity had been compromised to such detrimental extent until the death of Ellis and until Ellis' replacement, Ms. Barber, proceeded to initiate internal investigations into SIA's financials. These meeting minutes are not conclusory, but are certainly evidence favorable in showing that outside of Ellis and Zackler, the other directors had little, if no influence, on SIA's budgetary practices and decisions, or other key financial decisions. In Sidler, the Chariman of the Finance Committee, member of the Investment Committee, and Treasurer, Mr. Ernst, exercised dominant control over investment decisions as well as "discouraged and flatly refused to respond to inquiries by other directors into such matters." It was only after his death that other directors "appear to have assumed an identifiable supervisory role over investment policy and Sidley's fiscal management in general."

In applying Sidler to SIA, SIA's financial reports appear to be the sole responsibility of Zackler, and Zackler would make a presentation of SIA's financial report in his capacity as Chair of the Finance and Budget Committee once each quarter. Based on review of the Board's Meeting Minutes, Zackler's presentations were almost always oral. Ellis would present expense reports of the Executive Director and submit them to the Board for approval. Although Ellis did this once each quarter, the Meeting Minutes suggest that the Board was inclined to approve of these expense reports because Zackler would personally "assure the Board of the accuracy of the expense reports" (Barber

interview). On nearly each occasion, one member of the Board or several members would raise concern regarding some aspect of SIA's financials. Each time such a concern was raised, Zackler would provide his assurances that the budgets were on target, that increases in staff travel reimbursements were "legitimate expenses associated with the increase in public seminar programs" and that each expenditure had been personally reviewed by him. With Zackler the Chair of the Finance and Budget Committee, the other directors had little ability to supervise or challenge Zackler, and certainly did not have not any "identifiable supervisory role" over any SIA financial policy at large.

Therefore, based on my analysis of the Sidler case in conjunction with the Meeting Minutes and pertinent facts disclosed from Ms. Barber's interview, it is my conclusion that the meeting minutes are strong indicators that SIA's directors had no identifiable supervisory role over investment policy until the passing of Ellis.

(b) No Other Members of SIA's Board of Directors Were Involved in Fradulent Practices or Profited Personally by Lapses in Fiscal Management

With respect to SIA's Board of Directors, there is no indication that any of its directors were involved in fradulent practices. As the Court in Sidler concluded, the overall operation of the Sidley corporation was superior in terms of low costs, efficient services, and quality patient care. There was no further evidence of any wrongdoing by any of the other directors. Ms. Barber has stated in her interview that there are no other lapses in fiscal management--specifically, that the overall financial health of SIA is healthy, as they have a steady stream of charitable donations coming in as well as foundational grants that are up for renewal.

(c) SIA Must Initiate Voluntary Action In Good Faith Before the Expiration

of the 30-Day Period

In reversing the trial court's decision, the Sidley court emphasized that the function of equity is not to punish and in the event that "voluntary action has been taken in good faith to minimize such recourrence" the court must take into account this factor when formulating relief. Furthermore, the dissolution of the Sidley charity was not necessary because there was no indication that any of the other directors were involved in fradulent practices or profited personally by lapses in fiscal supervision. This is certainly analogous to the issues that SIA is facing at the present.

As applied to the facts at hand with respect to SIA, the Sidley court's ruling is not a guarantee against dissolution; however, it is certainly an argument that finds in favor of SIA, so long as SIA can provide strong, defensable evidence that it has taken any and all actions necessary to prevent improper conduct. Thus, as Ms. Barber stated, Ellis has already passed and at present, Zackler's term is soon expiring. With a new Board to be in place, communication of this transfer of powers to the AG should be measures sufficient to show that no further wrongdoing is present or imminent at SIA. However, I would also suggest that SIA seek to divide any and all Board financial positions so that the deciding powers do not rest solely with one person. If the AG believes that the corporate board structuring has been unchanged (e.g. the potential for another director to dominate over any issue of finance), the likelihood of the AG pursuing dissolution runs far higher.