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NONPROFITS: CALIFORNIA ATTORNEY GENERAL

New Charity Enforcement by CA Attorney General

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Our IRS Audits and Attorneys General Investigations practice group is closely watching state-level developments of interest to the nonprofit sector, particularly in California.

First, in *CA Nonprofit Legislative Update* (April 5, 2022), the focus is on several bills under consideration in the halls of the Capitol building in Sacramento. Some have been "sponsored" or "supported" by the California Association of Nonprofits. And at least one controversial measure is being closely "watched": a proposal to deny tax-exempt status to organizations involved in the Washington, D.C. insurrection activities on and before January 6, 2021. See CalNonprofits' regularly updated Legislation Tracker.

Second, in *Nonprofits Reaching for Piece of CA Budget Pie* (April 11, 2022), we discuss how our sector can and should be involved *right now* in the critical debate over budget priorities and allocations for the upcoming 2022-2023 fiscal year. For the second time in a row, there is a substantial surplus, on top of still-available federal funds for state and local governments from last year's American Rescue Plan Act. Under this statutorily prescribed process, the public is invited and encouraged to actively participate by commenting on the Governor's detailed proposed budget or submitting entirely new ideas, plans, and projects.

Now, we turn to oversight activities by the California attorney general's office. For background, see *Say What? We're Monitored by How Many Government Agencies?* (March 5, 2015) and *The Charity Oversight Role Of The California Attorney General: An Introduction* (April 24, 2015).

At a national professional conference at the end of March, California's Supervising Deputy Attorney General, Elizabeth S. Kim, Esq., touted the successful conclusion of two cases and mentioned a third one nearing completion (which has since been formally announced). See EO Tax Journal 2022-

64 (March 31, 2022), Paul Streckfus, Editor (paywall).

Case One: Misappropriating Assets

In the 1950's, a generous couple in Bakersfield, California created the Pelletier Foundation for "agricultural and charitable purposes." Their only daughter, Sandra Denisen, eventually took over the operations. By the time she passed away in 2019, evidence had been uncovered of significant diversion of funds.

The Attorney General's office undertook "an enforcement action" to recover the misappropriated or misused money totaling hundreds of thousands of dollars. Procedurally, the government regulators filed a claim against Ms. Denison's estate as well as a petition to "reclaim any assets that she held onto that were the foundation's assets."

The foundation and the estate agreed to pay $600,000 in cash as well as for the recovery and transfer of certain mineral rights located in Texas. The next step included applying to the probate court to approve a "cy pres" distribution of these recovered amounts and assets over to an entirely unrelated foundation in the same locale. The funds are expressly restricted; they can "only be used for agricultural charitable purposes."

Case Two: Fundraising After Dissolution

This second item began as a civil investigation but turned into a criminal matter. See *Attorney General Becerra Announces Sentencing in AIDS Research Alliance Fraud Scheme*, *Press Release,* February 8, 2021.

Donnelly Montenegro was formerly the acting CEO of a nonprofit involved with AIDS research and treatment. The charity dissolved in 2015, but that didn't stop Mr. Montenegro from continuing to raise funds. "[B]ecause of his role and access to documents of the group, he pretended that nothing had changed" and "led donors to believe that the charity was still operating."

Over the next two years, Mr. Montenegro "raised hundreds of thousands of dollars and he used those funds on himself to pay credit cards, to buy firearms, and to make investments." When these "egregious actions" were uncovered and evaluated, the AG's office turned the matter over to its Criminal Division and its Special Prosecution unit. Eventually, they issued a 22-count criminal complaint against him including six counts of grand theft, three counts of identity theft, and 13 counts of money laundering.

Donnelly Montenegro pleaded guilty to grand theft by fraudulent pretenses. The plea deal included a two-year prison sentence which he is currently serving.

Case Three: Fiscal Sponsor Converts Funds

The third case briefly mentioned by AG official Elizabeth Kim involves "an issue that many regulators are now seeing regularly": namely, problems of diversion in fiscal-sponsorship situations.

A week later, on April 7, 2022, Attorney General Rob Bonta announced in a press release a stipulated judgment agreed to by the charity defendant, ZeroDivide, and several of its officers individually. See civil complaint filed April 7, 2022 here; see also a copy of the stipulated judgment here, entered into immediately but subject to court approval.

"What happened here," according to the AG's press release, "is we have a charity that is a fiscal sponsor for a local program and it received donations and grants for that program, but when it ran into fiscal or financial troubles, what it did was spend those restricted assets for their overhead expenses."

The civil complaint alleged that the defendants had misspent over $600,000 in restricted donations meant to fund two of its charitable programs. Instead, the money was used "to cover salaries and benefits for employees who did not work on those programs, and to fund other programs."

"We are recouping over $300,000 that we will give to the new fiscal sponsor for the program. In addition, we are recouping our attorneys' fees and getting penalties personally from the directors and also asking for some sector ban of the directors."

See the text of the press release as well as a more detailed discussion of this case in *Stipulated Judgment Against Fiscal Sponsor for Misspending Donations* (April 9, 2022), Gene Takagi, Esq., *NEO Law Blog:* ["Fiscal sponsors must respect laws related to protecting assets restricted to furthering the charitable purposes of specific projects. If funds intended for a particular internal (Model A) project are diverted and used for other purposes (e.g., the fiscal sponsor's general operating expenses), there may be legal repercussions."]

Attorney Takagi includes a helpful final section with a 10-point "Lessons to Be Learned for Fiscal Sponsors."

Conclusion

Over the years, we've covered a few particularly juicy cases from the California Attorney General's Office. An early favorite is People v. Matthew Bishop, pdf. The 2014 "Petition for Removal of Trustees, … An Accounting, and to Void the Transfer of Trust Property to Trustee" set out the facts and figures unearthed in the investigation of this stew of shenanigans.

Our take at this early stage of the proceedings is at *A Recipe For How To Get Noticed By The California Attorney General* (May 1, 2015) ["Recently, two fellows in Napa, California, have been cooking up a hearty feast of trouble; … Armed with keys to the kitchen, an executor and trustee was off and running planning a menu of misdeeds – along with a compliant co-trustee."]

Resolving the matter took a few years but eventually, in 2018, various defendants agreed to pay to the People of California as well as to the original testamentary trust that was defrauded money damages of hundreds of thousands of dollars including substantial attorney's fees. And while the Settlement Agreement included the standard denials of any wrongdoing, let's just say that none of these individuals will ever again hold any position of responsibility or involvement with charitable organizations, trusts, or funds.

– Linda J. Rosenthal, J.D., FPLG Information & Research Director