



Fall 2014

## Business Law Newsletter

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## NONPROFIT LEGAL COMPLIANCE--How You Can Avoid Liability When You Join a Non-Profit Board

By Alena M. Herranen, Esq.

When you volunteered to become an officer of your California nonprofit



corporation, you may have thought you would be spending your volunteer hours bringing musical education to public schools, raising money for scholarships, or working toward some other laudable charitable goal. This is true. However, what you may not have realized is that you have also accepted a small host of legal responsibilities. As an officer or director of a California nonprofit corporation, you have a duty to act on behalf of the corporation to ensure that the corporation complies with state and federal laws.

You certainly want to be focusing your time on charitable work rather than legal compliance. Attorneys knowledgeable in the ins and outs of non-profit legal compliance can efficiently guide you through the process so you can do exactly that. As the attorneys for your nonprofit corporation, we would conduct a corporate health check-up to identify tasks that need to be completed, and we would help you complete these tasks efficiently to minimize any distraction from your core goals.

A corporate health check-up will generally involve a three stage process.

### I. Gather Information from officers and directors

The first step in your corporation's health check-up is to determine its current condition by gathering corporate information from the officers



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and directors. We would want to know what documents have been filed in the past, what documents should have been filed, and whether any government agencies are claiming that the corporation is delinquent. We would want to talk to the officers and directors and review the corporate records.

## II. Review third party records

Should we find that your corporate documents are unavailable for any reason, we may seek to obtain them from the Secretary of State, Attorney General, Recorder/County Clerk, Franchise Tax Board, IRS or other third parties. Each one of these agencies has filing requirements, and it is important to know what information or documents your corporation has filed in the past.

### Secretary of State

The California Secretary of State processes many corporate filings including the articles of incorporation, statements of information, mergers and dissolutions.

### Attorney General

The California Attorney General regulates charities and administers a statutory registration program. All charities are required to register and file annual financial disclosure reports with the Registry. In addition, nonprofit organizations that conduct raffles for charitable purposes are required to register and file a financial report for each raffle held.

### Recorder/County Clerk

The Recorder/County Clerk registers fictitious business names.

### Franchise Tax Board

The Franchise Tax Board requires nonprofit corporations to file Form 199N or Form 199 annually. Organizations with gross receipts that are normally equal to or less than \$50,000 are required to electronically file FTB 199N, California e-Postcard. Organizations with normal gross receipts in excess of \$50,000, must file Form 199. If the organization has been in existence for three or more years, then "normally less than \$50,000" means the organization has earned an average of \$50,000 or less per year over the last three years.

### Internal Revenue Service

The Internal Revenue Service requires that nonprofit corporations file a tax e-Postcard or a tax return annually regardless of gross receipts. If the organization has less than \$50,000 in gross receipts, then it can file the Form 990-N.

Organizations with gross receipts in excess of \$50,000 but less than \$200,000 may file the Form 990-EZ. Organizations with gross receipts in excess of \$200,000 or with assets in excess of \$500,000 must file the Form 990.

### California Board of Equalization

The Board of Equalization issues seller's permits and handles property tax exemptions.

### EDD

The Employment Development Department (EDD) requires registration by employers. If the corporation has employees, then it has probably filed Form DE1 NP "Registration Form for Nonprofit Employer" with the EDD.

### III. Create and carry out an action plan

After searching the official records and reviewing records provided by the officers and directors, we will create an action plan outlining tasks that need to be done. If the organization is not in compliance, we would work with you to bring your organization into compliance as soon as possible. We would also create a list of annual tasks to help the officers of the corporation maintain the organization's good standing.

In short, we strive to minimize the burden of legal compliance so that your nonprofit corporations' officers and directors will be free to pursue the corporation's charitable purpose.

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## Recent Appellate Decisions

By Jonathan P. Geen, Esq., Esq.

### **Federal**

In the case of *Reese v. Malone* (2014) 747 F.3d 557, the Ninth Circuit reversed the part of a decision of the trial court that dismissed the plaintiff shareholders' putative class action which alleged that the corporation knowingly or with deliberate recklessness made false and misleading statements about the conditions of pipelines. The Ninth Circuit held that the shareholders had adequately alleged

falseness and materiality against the company's officers who had described the pipeline's corrosion rate as "low" and "manageable," especially because the complaint had alleged that the officer had a technical background, which the Ninth Circuit stated created a strong inference of scienter. The Ninth Circuit agreed with the trial court, however, that the plaintiffs had not sufficiently alleged scienter with respect to the CEO and his statement regarding the company's "world-class corrosion monitoring and leak detection systems."

In the case of *World Trade Financial Corp. v. U.S. Securities & Exchange Commission* (2014) 739 F.3d 1243, the court upheld the decision by the SEC ordering payment of sanctions by a broker-dealer and its principals imposed by the Financial Industry Regulatory Authority (FINRA) for unregistered securities from which a restrictive legend had been improperly removed. The court of appeals rejected the broker-dealer's assertion that it had conducted a reasonable inquiry before selling the securities. Therefore, the Ninth Circuit held that the broker-dealer was not entitled to the broker's exemption from liability under the Securities Act. The Court of Appeals further determined that fines and sanctions were not an abuse of discretion by the SEC.

#### **State**

In the case of *Busse v. United Panam Financial Corp.* (2014) 222 Cal.App.4th 1028, the Fourth District affirmed in part and reversed in part the trial court's order sustaining defendant's demurrer without leave to amend in an action brought by minority shareholders against majority shareholders for breach of fiduciary duty. The Fourth District agreed with the trial court that the plaintiffs as dissenting minority shareholders could not make common-law claims for damages against the majority shareholders. However, the Fourth District reversed the trial court's granting of a demurrer with regard to the plaintiff's causes of action for rescinding a buyout. The Court of Appeal found that the chairman's control of the corporation was sufficient to support the remedy of rescission as provided by California Corporations Code section 1312(b).

In the case of *Powerhouse Motor Sports Group, Inc. v. Yamaha Motor Corp.* (2013) 221 Cal.App.4th 867, the Court of Appeal affirmed the judgment of the trial court in favor of the plaintiff automobile franchisee and against the manufacturer, Yamaha, for unreasonably withholding its consent to the sale of the dealership and franchise in violation of the California Vehicle Code section 11713.3. The Second District agreed with the trial court that Powerhouse's ability to assert damages against its

franchisor, and the award of \$1.3 million in compensatory and punitive damages, was not lost when the dealer failed to comply with Yamaha's internal procedure for challenging termination of the franchise agreement.

In *Leyte-Vidal v. Semel* (2013) 220 Cal.App.4th 1001, the Court of Appeal affirmed the trial court's order sustaining defendant's demurrer without leave to amend with regard to a derivative action a shareholder plaintiff had brought against the corporation's officers and directors. The complaint purported to state claims for breach of fiduciary duty for improper financial reporting, insider selling, abuse of control, and related claims. The Court of Appeal agreed that the shareholder had failed to plead with particularity that the directors were so interested so as to excuse a shareholder demand before filing suit. The Court of Appeal further agreed with the trial court that the plaintiff failed to plead with particularity that the directors were "dominated and controlled" by the founder. The court found the trial court's order sustaining defendant's demurrer without leave to amend was justified when the plaintiff had been granted an opportunity to amend on three separate occasions.



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#### DISCLAIMER

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