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UCAN Boardmembers:

I am contacting the board pursuant to Rule 3-600 of the California Rules of Professional Conduct,¹ to inform the board of unlawful conduct by UCAN's executive director, Michael Shames. I believe that this conduct represents an existential threat to UCAN, and I urge the board to address it with all possible swiftness. This conduct is detailed and documented as follows.

1. Unlawful Bonuses

Executive director Michael Shames benefits from an unlawful bonus scheme under which he receives a 10% share of all intervenor compensation awards. The attached receipts show that between August 2008 and June 2009 Shames was awarded at least \$116,678 in bonuses. (Attachment 1). For the May 2009 (SDG&E AMI) and June 2009 (SBC) bonuses, I've attached copies of the Public Utilities Commission decisions granting the intervenor compensation awards. These decisions demonstrate that Shames' bonuses are based on the entire intervenor compensation awards, not merely the fraction of the award directly attributable to his billable hours. (Attachment 2)

Colleagues have informed me that this bonus arrangement has been in place for at least a decade. These bonuses are not listed in any of UCAN's publically available IRS filings. (Attachment 3).²

This bonus scheme violates Internal Revenue Code § 501(c)(3), which provides that no part of a tax exempt organization's net earnings may inure (be distributed) to the benefit of any private shareholder

¹ Rule 3-600 provides that an attorney working for an organization may, if warranted by the seriousness of the matter, refer unlawful or harmful conduct to the organization's highest authority (in this case, UCAN's board).

² For reference I have attached UCAN's 2008-2009 IRS-990. UCAN's 990s for 2000-2009 can be retrieved by using the California Attorney General's Registry of Charitable Trusts' website's registry search feature, available at <http://ag.ca.gov/charities/>

or individual. "In audits, the IRS typically takes the position that any sharing of net profits between an insider and a charity is per se private inurement." (Advising California Nonprofit Corporations (3d ed Cal CEB 2009) § 3.15, Prohibition on Inurement). Shames' bonuses constitute an even more egregious violation of the inurement prohibition than a traditional distribution of net profits, as Shames takes a 10% share of gross revenue (i.e. before expenses), rather than a cut of net profit (what's left over after expenses have been accounted for).

I also feel that it is my duty to advise you that each member of the board may be exposed to personal liability due to these unlawful bonuses. I strongly suggest that the board consult outside counsel on this matter.

Aside from the potential legal consequences, I believe that this bonus scheme has severe public relations and ethical implications. UCAN is an organization that thrives, in large part, due to its public reputation for honesty and advocacy. UCAN is seen as a watchdog – an organization that protects consumers from corrupt and abusive utilities. If the public were to find out that an organization occupying such a place of trust had been awarding its Executive Director hundreds of thousands of dollars in unlawful bonuses, UCAN's image and legitimacy would be effectively destroyed.

At a minimum, I believe that the board must end this unlawful bonus scheme, report all bonuses that have been awarded under this scheme to the IRS, Franchise Tax Board, and California Attorney General, and cooperate fully in any resulting investigations.

2. Unlicensed Practice of Law

Michael Shames is registered with the State Bar of California as inactive, and has been since 1988. Despite this, Shames regularly holds himself out to be an attorney and engages in the practice of law. Attached is one of many examples of Shames publically holding himself out as an attorney. (Attachment 4). Shames has also engaged in the practice of law by requesting attorney's fees from the California Public Utilities Commission. (Attachment 5a, 5b). In at least one instance Shames has represented UCAN as an attorney before the California Court of Appeals, Second District by filing an Amicus Brief (Attachment 6).

Under California Business and Professions Code § 6126(a): "Any person advertising or holding himself out as practicing or entitled to practice law or otherwise practicing law who is not an *active* member of the State Bar, or otherwise authorized pursuant to statute or court rule to practice law in this state at the time of doing so, is guilty of a misdemeanor." (Emphasis added).

Under Rule 3-600 of the California Rules of Professional Conduct, an attorney "shall not aid any person or entity in the unauthorized practice of law." By allowing Shames, an employee, to practice law without a license, the attorneys on UCAN's board may fall within the scope of this rule.

I advise the board to take all steps necessary to prevent Shames from any further unlicensed practice of law. I also advise all attorney board members to seek independent counsel specializing in ethics issues.

3. Failure to Audit as Required by Law

UCAN is currently in violation of the Nonprofit Integrity Act of 2004 (Gov. Code § 12586(e)(1)), which requires that nonprofits with over two million dollars in gross revenue³ subject their finances to a thorough and independent audit. The most recent review of UCAN's finances (Attachment 7) was limited to a "review" which "consists principally of inquiries of the organization's personnel and analytical procedures applied to financial data." This review "is substantially less in scope than an audit in accordance with auditing standards generally accepted in the United States." (Attachment 7). Rather than being conducted by an independent auditor as required by the Nonprofit Integrity Act, UCAN's review was conducted by Gregory Villard, UCAN's usual accountant.

In order to avoid possible penalties for violation of the Nonprofit Integrity Act and insulate itself from personal liability, the board should immediately have UCAN's finances audited by an independent auditor. The auditor should be selected and overseen solely by UCAN's board.

4. Suspicious Bank Accounts

Shames currently has at least four investment accounts under the name "Utility Consumers Action Network" (spelled with an "m" rather than an "n") rather than "Utility Consumers Action Network." (Attachment 8). The accounts are with the American Stock Transfer and Trust Company, Ironstone Bank, BNY Mellon, and Morgan Stanley. All share the same address with UCAN.

The Board of a California nonprofit has a fiduciary duty of "reasonable inquiry" when circumstances indicate that further inquiry is needed. (Corp. Code § 5231; *see also* Advising California Nonprofit Corporations (3d ed Cal CEB 2009) § 9.110, Director's Duty of Inquiry; Right to Rely on Advice of Others).

In order to satisfy its duty of inquiry, I advise the Board to procure complete transactional records directly from each bank, have the records analyzed by an independent auditor, and, if appropriate, notify the IRS and Franchise Tax Board of the results.

5. Conclusion

I would be more than willing to consult with the board to answer any questions raised by this letter. I urge you seriously consider the information and legal advice provided in this letter and take all steps necessary to remedy the unlawful activity described herein.

Sincerely,

/s/

David A. Peffer, Esq.

³ UCAN's 2010 revenue was 3.3 million