RETHINKING *RILEY*: NEW APPROACHES TO STATE AND FEDERAL REGULATION OF CHARITABLE SOLICITATION

James J. Fishman[*]

INTRODUCTION

In *Riley v. National Federation of the Blind of North Carolina, Inc.*,[1] the Supreme Court held unduly burdensome and unconstitutional a North Carolina statute requiring professional fundraisers to disclose to potential donors the average percentage of gross receipts they actually turned over to charities for all charitable solicitations conducted in the state within the previous twelve months.[2] The Court applied a strict scrutiny standard of review to the regulated speech, rather than a more deferential standard of review for commercial speech or economic regulation.[3] The Court's rationale was that the commercial speech elements of the charity's message were inextricably intertwined with its fully protected educational portions and were constitutionally protected, even if no money was raised.[4] North Carolina's regulations governing application of the statute were not narrowly tailored to achieve the state's valid interests in preventing fraud, protecting charities, and informing donors of how money contributed was spent.[5]

This Article disagrees with *Riley*'s rationale that the educational elements in charitable solicitation are so interwoven with commercial speech that governmental regulation of a charity's message is subject to strict

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[*] Professor of Law Emeritus, Haub School of Law at Pace University.

[1] 487 U.S. 781 (1988).

[2] *Id.* at 798. The Charitable Solicitations Act also defined the prima facie "reasonable fee" that a professional fundraiser could charge according to a three-tiered schedule. *Id.* at 784–85. A fee up to 20 percent of receipts collected was deemed reasonable; a fee between 20 percent and 35 percent was deemed unreasonable upon a showing that the solicitation at issue did not involve the dissemination of information, discussion, or advocacy relating to public issues as directed by the charitable organization that benefitted from the solicitation. *Id.* "[A] fee exceeding 35% [was] presumed unreasonable, but the fundraiser [might] rebut the presumption by showing that the amount of the fee was necessary either (1) because the solicitation involved the dissemination of information or advocacy on public issues directed by the charity, or (2) because otherwise the charity's ability to raise money or communicate would be significantly diminished." *Id.* at 785–86. Finally, the act provided that professional fundraisers could not solicit without an approved license, whereas "volunteer fundraisers [could] solicit immediately upon submitting a license application." *Id.* at 786–87.

[3] *Riley*, 487 U.S. at 798.

[4] *Id.* at 796.

[5] *Id.* at 792, 798.

judicial scrutiny as a matter of course and is protected by the First Amendment.[6] It suggests that this conclusion does not reflect the realities of typical fundraising speech, which is fundamentally commercial in nature, as opposed to educational or charitable. It argues that it is more appropriate for some charitable solicitations, where costs of fundraising over several years exceed 85 percent of the amount raised, to be subject to a lesser, intermediate standard of review by the courts.[7] Examining charitable fundraising from the perspective of the professional solicitor's role, and requiring disclosure of fundraising costs in certain circumstances, should pass constitutional muster because it protects the public from deception and manipulation.

Part I of this Article describes the business of professional solicitation and the challenges that charities face in using solicitors. Part II provides an overview of attempts by states to regulate charitable solicitation and discusses three Supreme Court cases that have weighed on these attempts. Part III discusses the regulatory scene after *Riley*, paying particular attention to mandated disclosures of financial and other information by charities. Part IV addresses the states' attempts to regulate charitable solicitation by enforcing the requirement that charities provide some larger societal purpose and public benefit beyond those accorded to individuals associated in some way with the charity. Finally, Part V argues that courts should apply an intermediate standard of review where organizations provide a disproportionately small value compared to their solicitations. The Article concludes that because a significant amount of fundraising speech is commercial rather than educational in nature, an intermediate standard of review is appropriate because it more adequately allows a balancing of states' interests in protecting their citizens by assuring honesty in charitable solicitations.

I. PROFESSIONAL SOLICITATION

Nearly all charities raise funds from the public or from grantmaking entities to survive and thrive.[8] Most established organizations conduct their

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[6] There is an exception for fraudulent or deceptive solicitation, which does not receive constitutional protection. *See id.* at 795.

[7] Recommendation for applying an intermediate standard of review was suggested by Professors Espinoza and Inazu in their analyses of an earlier case relating to charitable solicitation, *Schaumburg v. Citizens for a Better Environment*, 444 U.S. 620 (1980), which was ambiguous on the standard to be applied. *See* Leslie G. Espinoza, *Straining the Quality of Mercy: Abandoning the Quest for Informed Charitable Giving,* 64 S. CAL. L. REV. 605, 607, 618–19 (1991); John D. Inazu, *Making Sense of* Schaumburg*: Seeking Coherence in First Amendment Charitable Solicitation Law*, 92 MARQ. L. REV. 551, 565–72 (2009).

[8] Two exceptions are private foundations and certain social services nonprofits, the latter organized separately from but completely funded by government sources. Private foundations are charities that have failed several complicated tests of public support. *See* I.R.C. § 509. Most foundations need not fundraise because they have an endowment from which they cover administrative costs and make grants. *Id.*

fundraising through professional fundraising firms that plan and make the solicitation to the public.[9] Not surprisingly, given the amount of money involved—$390.1 billion in 2016—charitable solicitation has developed into a sophisticated and lucrative business.[10] Professional solicitation firms are necessary accompaniments to nonprofit activity.[11] They can be efficient and effective enablers of an organization's financial solvency and ability to achieve its charitable mission.

Professional solicitors are stratified by client, method of compensation, target audience, ethics and practices, and reputation.[12] Firms often offer their services for a fee or take a percentage of the amount raised.[13] Fee for services is the more reputable approach.[14] Charitable solicitation is big business.[15] As

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9 "Fundraising counsel are typically companies that work for a flat fee, have established charities as clients, and perform little or no in-person or telephone solicitation." *Developments in the Law—Nonprofit Corporations: Charitable Solicitations*, 105 HARV. L. REV. 1578, 1639 (1992). "'Fund raising counsel.' Any person who for compensation consults with a charitable organization or who plans, manages, advises, or assists with respect to the solicitation in this state of contributions for or on behalf of a charitable organization, but who does not have access to contributions or other receipts from a solicitation or authority to pay expenses associated with a solicitation and who does not solicit. A bona fide officer, volunteer, or employee of a charitable organization or an attorney at law retained by a charitable organization, shall not be deemed a fund raising counsel." N.Y. EXEC. LAW § 171-a(9) (LexisNexis 2014).

10 *See* Press Release, Giving USA, Giving USA 2017: Total Charitable Donations Rise to a New High of $390.05 Billion (June 12, 2017), https://givingusa.org/tag/giving-usa-2017/.

11 *See generally id.*

12 *See generally* Claire Wallace, *3 Creative Agencies Doing Good with Nonprofit Marketing*, Agency Spotter, https://co.agencyspotter.com/3-creative-agencies-for-nonprofit-marketing/.

13 *See* OFFICE OF THE MASSACHUSETTS ATTORNEY GENERAL NON-PROFIT ORGANIZATIONS/PUBLIC CHARITIES DIVISION JANUARY 1, 2012 TO DECEMBER 31, 2013, 7 (2014), www.mass.gov/ago/docs/nonprofit/professional-solicitations- reports/pro-solicit-2013.pdf.

14 According to a report by the Massachusetts Attorney General:

> The percentage of monies raised that goes to the charity can vary widely. The terms of each campaign are agreed upon by both the solicitor and the charitable organization and are reflected in the contracts that are filed with the [Attorney General's Office]. In some contracts, the charity agrees to accept a percentage of funds raised, but it is far more common for the contract to set forth the solicitors' cost of performing the services involved in the campaign (for example, a per-call or per-contact charge or an hourly charge) and for the charity to agree to pay those costs and then retain the remainder of gross proceeds from the campaign. The percentage of gross proceeds received by the charity in those types of arrangements depends on the cost of the service and the results of the campaign rather than an agreed-upon percentage.
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> The cost of the solicitation service, in turn, also depends on a number of factors, including the type of campaign the professional solicitors are hired to run. Some firms are hired to run major events; some are hired to conduct telemarketing; some are retained to do face-to-face canvassing. Still others are hired to help with "fulfillment" during a fundraising campaign. This last category includes organizations that maintain 24/7 phone banks to receive calls from potential donors generated by television, radio or other advertisements that may be viewed well outside of normal business hours.
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> Ultimately, the amount of the funds raised that goes to the charity is a function of the agreement that the charity and the professional solicitor have made and the results of the campaign. As noted above, there is no legally required minimum amount or percentage of funds raised that must go to the charity.

Id.

15 *See* Giving USA, *supra* note 10.

in any area of commerce (or life), participants are faced with competition and may be negatively impacted by the abuses of some industry competitors. The criticisms discussed relate to a small and ethically challenged subset, not to the profession as a whole.[16]

When a charitable contribution has been made, there often is no discernible outcome to the donor save the "warm glow" of feeling altruistic.[17] A contribution is usually an act of faith that money donated is put to its promised use.[18] Indisputably, some fraudulent or misleading charitable solicitation exists.[19]

Many charities conduct all their charitable solicitations through professional fundraising firms that plan and actually make the solicitations.[20] If the fundraiser uses its own funds to run a campaign, usually its reimbursement comes from the dollars raised by donors' contributions.[21] The solicitor is repaid "off-the-top."[22] In other words, the solicitor receives the first dollars

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16 When the fraud of deceptive or fake charities, such as Disabled Navy Veterans, which used the emotive name "Veterans," is uncovered, legitimate veterans' charities may fear they will feel the effects of the wrongdoing. *See* Kris Hundley, *U.S. Navy Veterans Association Charity Fraud Trial Ends with Bobby Thompson Guilty on All Counts,* TAMPA BAY TIMES (Nov. 14, 2013, 9:43 AM), http://www.tampabay.com/news/courts/criminal/us-navy-veterans-association-charity-fraud-trial-ends-with-bobby-thompson/2152382.

17 The phrase "warm glow" was coined by Professor James Andreoni in his article *Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving*. 100 ECON. J. 464, 464 (1990).

18 *See* Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 505 (1981). Sometimes that faith is unjustified. A reporter sponsored a girl from Mali through Save the Children Federation Inc. and decided to visit the child. *See* Lisa Anderson, *The Miracle Merchants*, CHI. TRIB., Mar. 15, 1998, at 1. The sponsored child had been dead for two years, and letters to donors purportedly from children were written by the organization. *Id.* The same type of deception was alleged against World Vision, a "charity whose website highlights faces and biographies of children from impoverished places around the world." *See* Diaa Hadid, *A World Vision Donor Sponsored a Boy. The Outcome Was a Mystery to Both*, N.Y. TIMES (Aug. 2, 2016), https://www.nytimes.com/2016/08/03/world/middleeast/worldvision-palestinians-sponsor-a-child.html?mcubz=1. World Vision advertised that a person could sponsor a child for $39 a month. *Id.* An Australian paid $1,100 over several years to sponsor a Palestinian child but never heard from him. *Id.* A reporter tracked down the child. *Id.* Neither the child nor his relatives knew he had been sponsored. *Id.* Nor did the child or his family receive any direct support, though the charity had contributed money to the village in which the child lived. *Id.*

19 *See* Hadid, *supra* note 18; *see also infra* notes 34–45.

20 NEW YORK STATE OFFICE OF THE ATTORNEY GENERAL, CHARITIES BUREAU, PENNIES FOR CHARITY: WHERE YOUR MONEY GOES: FUNDRAISING BY PROFESSIONAL FUNDRAISERS 1 (2016). Established charities often have a development office with in-house staff, whose primary functions are to plan the organization's fundraising campaign, minister to the care and feeding of existing donors, and cultivate new supporters. *See* Sam Ashe-Edmunds, *Description of a Nonprofit Development Department*, AZCENTRAL, http://yourbusiness.azcentral.com/description-nonprofit-development-department-16134.html (last visited Sept. 25, 2017). These employees are not called "professional solicitors" or "fundraisers" but have a more prestigious title of "fundraising counsel." *See Developments in the Law*, *supra* note 9, at 1639–40. Established charities will likely outsource to a telemarketing firm the actual solicitation of the public.

21 *See* NEW YORK STATE OFFICE OF THE ATTORNEY GENERAL, *supra* note 20.

22 *See id.* at 2.

contributed. For smaller charities, the lure of retaining a professional fundraising firm is that the charity seems to be in a win–win situation. The fundraiser assumes the out-of-pocket costs of the campaign, and every dollar raised for the organization is a dollar that the charity did not previously possess.[23] Most donors are unaware that 70–90 percent of their contribution may not reach the organization but goes to the fundraiser. A surprising number of fundraising campaigns lose money, so the charity receives nothing and, in some circumstances, owes the fundraiser money after the campaign is over.[24] Inefficient and losing solicitation campaigns still may benefit a charity. Not every fundraising campaign's purpose is raising substantial sums of money.[25] The solicitation may be an effort to educate the solicited about a new, unknown, or controversial cause. In this situation, the charitable solicitation is intertwined with constitutionally protected free speech.[26]

Scraping the bottom of the solicitation barrel, one finds fundraisers and charitable organizations that may be fronts for the solicitor or an organization's officers or directors. The primary purpose of such organizations is self-enrichment of the individuals involved, rather than fundraising for the charity or spreading a particular message.[27] These individuals, a small part of the fundraising and charitable communities, engage in misrepresentation, deceit, and fraud.[28] Such operations are surprisingly difficult to shut down absent a national consent decree to cease their activities—a rare event.[29] Such firms may be driven from one state to another or change their corporate names and continue in business.[30]

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23 *See generally id.*

24 This occurs more often than one would think. In 16.8 percent of fundraising campaigns or 192 of the 1,143 campaigns in New York in 2015, expenses exceeded revenues raised for a loss of $16.7 million to the charities involved. *Id.* at 1. Losses can occur when the fundraising contract does not guarantee the charity a specific dollar amount or specific percentage of the gross receipts, including when fundraising is incidental to the telemarketing campaign, or when the contract does not hold the charity harmless for expenses/fees that exceed the gross amount contributed. *Id.* at 2. Some of these losing campaigns were not intended to raise money but focused on finding new and promising donors or educating individuals unaware of the organization and its mission. *Id.*

25 *See* NEW YORK STATE OFFICE OF THE ATTORNEY GENERAL, *supra* note 20.

26 *See* Riley v. Nat'l Fed'n of the Blind of N.C., Inc., 487 U.S. 781, 797 (1988).

27 David Fitzpatrick & Drew Griffin, *Cancer Charity Targeted by Feds Agrees to Put Itself Out of Business*, CNN (Feb. 15, 2016), http://www.cnn.com/2016/02/15/us/cancer-fund-of-america-dissolution-agreement/.

28 *See* NEW YORK STATE OFFICE OF ATTORNEY GENERAL, *supra* note 20, at 1.

29 *See* James J. Fishman, *Who Can Regulate Fraudulent Charitable Solicitation?*, 13 PITT. TAX REV. 1, 17 (2015).

30 *Id.* at 2.

A. *The Problem of Solicitation Fraud*

The scenario is common: a charity—typically with a name including an emotive word, such as "cancer," "children," "firefighters," "police," or "veterans"—signs a contract with a professional solicitor to organize and run a campaign to solicit charitable contributions. The charity may be legitimate or a sham. The directors of the charity may be allied or coconspirators with the professional solicitor or, as likely, well-meaning but naïve individuals. The fundraiser raises millions of dollars through telemarketing, internet, or direct mail solicitation. The charity receives but a small percentage of the amount raised or nothing.

"Abuses by some nonprofits in soliciting funds from the public have been the most persistent problem facing state attorneys general in their regulation of charities."[31] In the overall context of the nation's charitable giving, the number of charity scams is small, but the amounts raised are surprisingly large.[32] The betrayal of donors' trust through charity fraud has a carryover effect on future giving, at least on those who learn their gifts were misspent.[33]

In *Federal Trade Commission v. Cancer Fund of America*,[34] a unique example of collaboration between state charity regulators and the Federal Trade Commission ("FTC"), the FTC and attorneys general of fifty states and the District of Columbia finally shuttered a long-existing group of sham cancer charities.[35] Cancer Fund of America, Breast Cancer Society, Cancer Support Services, and Children's Cancer Fund of America were cancer charities that raised $187 million from 2008 to 2012.[36] The organizations told prospective donors that they ran national programs, and their contributions would help people with cancer by providing pain medication to children

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[31] JAMES J. FISHMAN, STEPHEN SCHWARZ & LLOYD HITOSHI MAYER, NONPROFIT ORGANIZATIONS: CASES AND MATERIALS 219 (5th ed. 2015).

[32] *See, e.g.*, Fitzpatrick & Griffin, *supra* note 27.

[33] *See* Hundley, *supra* note 16.

[34] Complaint, FTC v. Cancer Fund of America, 2:15-cv-00884-NVW (D. Ariz. 2015). The case settled before an opinion was rendered.

[35] *See* Cameron McWhirter, *U.S. News: Charities Called $187 Million 'Sham'—Suit by FTC, 50 States Claim Four Cancer Groups Used Donations to Enrich Their Operators*, WALL ST. J., May 20, 2015, at A3; Rebecca R. Ruiz, *4 Cancer Charities Are Accused of Fraud*, N.Y. TIMES, May 20, 2015, at B1.

[36] Complaint, *supra* note 34. The plaintiffs alleged the deceptive conduct violated "Section 5 of the Federal Trade Commission Act ('FTC Act'), 15 U.S.C. § 45(a), and the Telemarketing Sales Rule ('TSR'), 16 C.F.R. Part 310, as well as state statutes regarding charitable solicitations and prohibiting deceptive and unfair trade practices." *Id.* at 3. The FTC brought the action under Sections 13(b) and 19 of the FTC Act, 15 U.S.C. §§ 53(b) and 57b, and the Telemarketing and Consumer Fraud and Abuse Prevention Act ("Telemarketing Act"), 15 U.S.C. §§ 6101-6108, to obtain temporary, preliminary, and permanent injunctive relief, rescission or reformation of contracts, restitution, the refund of monies paid, disgorgement of ill-gotten monies, and other equitable relief for Defendants' violations of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), and the TSR, 16 C.F.R. Part 310. *Id.* at 3–4.

suffering from the disease, transporting cancer patients to chemotherapy appointments, or paying for hospice care for cancer patients.[37] None of this was true.[38] Instead, the overwhelming majority of donated funds supported the organization's fundraisers, the individual defendants, and their families and friends in such activities as tuition payments, dating websites, ski outings, gym memberships, and cruises to the Caribbean.[39]

The complaint covered only four years, 2008 to 2012,[40] and the money raised during that period is probably long gone. James T. Reynolds, Sr., who organized the Cancer Fund of America in 1987, controlled the charities.[41] Although Reynolds's charities were disciplined by several states in the intervening years, his organization managed to survive.[42] Two of the defendant charities immediately settled with the regulators and dissolved.[43] Members of Reynolds's family and others affiliated with the organizations were barred from fundraising, charity management, and oversight of charitable assets.[44] Reynolds Sr., the perpetrator of the scheme, initially refused to settle, and the litigation continued against him, Cancer Fund of America, and Cancer Support Services, which was the fundraising arm; but a few months later, he agreed to go out of business.[45]

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37 Complaint, *supra* note 34, at 2–3.

38 *Id.* at 14.

39 *Id.*; *see also* Ruiz, *supra* note 35

40 Ruiz, *supra* note 35.

41 *Id.*

42 Fitzpatrick & Griffin, *supra* note 27.

43 *Id.*

44 David Fitzpatrick & Drew Griffin, *Government Says Four Cancer Charities Are Shams*, CNN (May 19, 2015, 9:15 PM), http://www.cnn.com/2015/05/19/us/scam-charity-investigation/index.html.

45 Two other leading cases of fundraising fraud in recent years include the Disabled Veterans National Foundation, which raised over $115 million using a professional solicitation firm, Quadriga Arts. *See* Assurance of Discontinuance at 2, *Investigation by Eric T. Schneiderman, Attorney General of the State of New York, of Disable Veterans National Foundation, et al.*, Assurance No. 14-145 (June 2014), https://ag.ny.gov/pdfs/DVNF-Quadriga-Convergence-AOD_14-145.PDF. More than 90 percent of the amount raised went for direct mail solicitation. *Id.* At the end of the campaign, the charity owed another $14 million to the solicitation firm that it could not pay. *Id.* As for any assistance to disabled veterans, it consisted of hand sanitizers, M&M's candies, chefs' hats, coats, and leftover shoes. David Fitzpatrick & Drew Griffin, *IRS Forms Show Charity's Money Isn't Going to Disabled Vets*, CNN (May 8, 2012), http://www.cnn.com/2012/05/07/us/veterans-charity-fraud/index.html. In an action brought by the New York attorney general, the fundraiser was required to forgive the debt and pay $9.7 million in damages. *See* Suzanne Perry, *N.Y. Wins $25-Million in Fundraising Abuse Case*, CHRON. PHILANTHROPY (June 30, 2014), http://philanthropy.com/article/NY-Wins-25-Million-in/147445/. The founding board members were forced to resign. *Id.* The full settlement agreement is available. *See* Assurance of Discontinuance, *supra*. In the aftermath of the settlement, the fundraiser, the subject of other complaints over the years, changed its name and remains in business. Suzanne Perry, *Quadriga, Accused of Misleading Donors, Reorganizes Under New Name*, CHRON. PHILANTHROPY (Dec. 17, 2014), https://www.philanthropy.com/article/Quadriga-Accused-of/152059.

The other is the U.S. Navy Veterans case, which involved the unfortunately common scheme of using a purported veterans' assistance charity. Ohio v. Cody, No. 100797, 2017 WL 1507211, at *1 (Ohio

It is not infrequent that by the time the attorney general or some other regulator such as the FTC disciplines or shuts down a fraudulent solicitation scheme, the money raised has been spent. Even if the perpetrators are barred from engaging in solicitation or serving on a charity board, there is little to deter others, and criminal prosecution is rare.[46] Many regulators, such as the Internal Revenue Service ("IRS") and most attorneys general, are ineffective or passive in this area. The FTC, the principal regulator in the *Cancer Fund of America* case, has no criminal prosecution authority.[47]

Many nonprofit trade associations preach self-regulation,[48] which often amounts to self-protection. Outliers, such as the organizations discussed above, could not care less about self-regulatory norms. As the following sections demonstrate, constitutional principles of freedom of speech, press, and religion place restraints on prior regulation of charitable speech and solicitation.

Ct. App. Apr. 21, 2017). The U.S. Navy Veterans Association raised $27.6 million in 2009 and an estimated $100 million in all. Ken Stern, *The Charity Swindle*, N.Y. TIMES, Nov. 25, 2013, at A25; Jeff Testerman & John Martin, *In 2008, IRS Audited Navy Veterans and Gave the Phony Charity a Clean Bill of Health*, TAMPA BAY TIMES (Nov. 18, 2010, 5:36 PM), http://www.tampabay.com/news/politics/national/in-2008-irs-audited-navy-veterans-and-gave-the-phony-charity-a-clean-bill/1135104. It boasted of a membership of 66,000 and offices in forty-one states, all of which did not exist. Stern, *supra*. The offices were post office boxes, and of the organization's eighty-four purported officers, the only one who could be traced was an individual called "Bobby Thompson," an identity stolen from a civilian in Washington State. *Id*.; *see also* Testerman & Martin, *supra*; Jeff Testerman & John Martin, *Multimillion-Dollar Nonprofit Charity for Navy Veterans Steeped in Secrecy*, TAMPA BAY TIMES (Mar. 20, 2010), http://www.tampabay.com/news/military/multimillion-dollar-nonprofit-charity-for-navy-veterans-steeped-in-secrecy/1081213. The U.S. Navy Veterans Association was unmasked not by federal or state charity regulators but through the investigative reporting of the *Tampa Bay Times*. Kris Hundley, *Bobby Thompson, Fugitive from Navy Vets Charity, Caught on West Coast,* TAMPA BAY TIMES (May 1, 2012), http://www.tampabay.com/news/business/bobby-thompson-fugitive-from-navy-vets-charity-caught-on-west-coast/1227828. "Ohio's Attorney General took the lead in pursuing" and prosecuting the perpetrator of the fraud, John Donald Cody. Hundley, *supra*; *see Cody*, 2017 WL 1507211, at *1. After a cross-country search, U.S. Marshals apprehended Cody in Portland, Oregon. Hundley, *supra*. A jury ultimately found him guilty of twenty-three counts of fraud, money laundering, and theft. Hundley, *supra* note 16. An Ohio judge then sentenced him to twenty-eight years in prison. Thomas J. Sheeran, *28-Year Sentence in Ohio in $100M Charity Scam*, ASSOCIATED PRESS (Dec. 16, 2013, 3:13 AM), http://www.sandiegouniontribune.com/sdut-100m-navy-charity-scammer-to-be-sentenced-in-ohio-2013dec16-story.html.

46 Fitzpatrick & Griffin, supra note 44.

47 FED. TRADE COMM'N, A BRIEF OVERVIEW OF THE FEDERAL TRADE COMMISSION'S INVESTIGATIVE AND LAW ENFORCEMENT AUTHORITY (2008), https://www.ftc.gov/about-ftc/what-we-do/enforcement-authority.

48 Jonathan T. Howe & Leland J. Badger, *The Antitrust Challenge to Non-Profit Certification Organizations: Conflicts of Interest and a Practical Rule of Reason Approach to Certification Programs as Industry-Wide Builders of Competition and Efficiency*, 60 WASH. U. L.Q. 357, 381 (1982).

II. APPROACHES TO REGULATION OF CHARITABLE SOLICITATION

A. *Regulation of Religious and Charitable Solicitation Through Issuance of Permits*

Riley did not occur on a blank slate. It was a consequence of differing strands of constitutional development concerning the limits of regulating free speech under the First Amendment.[49] Supreme Court scrutiny of restrictions on canvassing, including fundraising, by religious or charitable organizations has a surprisingly long history with several intersecting threads. The early cases addressed challenges to local and state ordinances that prohibited soliciting door to door, distributing literature, or asking for contributions absent a permit approved by a government official.[50] Some regulations prohibited door-to-door solicitation completely.[51] State courts construed these ordinances limiting house-to-house solicitation as a means of protecting homeowners from fraudulent solicitation.[52] They assumed the solicitors were engaged in their activities primarily for profit and therefore were not entitled to constitutional protection.[53] The effect of the earlier efforts at curtailment of canvassing was to limit the distribution of knowledge, obviously a free speech issue.

"A plurality of [the early] decisions turned primarily, if not exclusively, upon the amount of discretion vested in municipal authorities to grant or deny permits on the basis of vague or even non-existent criteria."[54] Many of the solicitors were members of religious groups, who combined their efforts to propagate their faith with requests for funds.[55] Another line of earlier cases involved the distribution of information, as opposed to requests for

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49 The First Amendment states: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances." U.S. CONST. amend. I.

50 Watchtower Bible & Tract Society of N.Y., Inc. v. Stratton, 536 U.S. 150, 160 (2002).

51 Martin v. Struthers, 319 U.S. 141, 151 (1943).

52 *See Watchtower*, 536 U.S. at 159.

53 *Id.* at 162.

54 Schaumburg v. Citizens for a Better Env't, 444 U.S. 620, 640 (1980) (Rehnquist, J. dissenting) (citing Schneider v. State, 308 U.S. 147, 163–64 (1939); Cantwell v. Connecticut, 310 U.S. 296, 305–06 (1940); Largent v. Texas, 318 U.S. 418, 422, (1943); Hynes v. Mayor of Oradell, 425 U.S. 610, 620–21 (1976)); *see also Watchtower*, 536 U.S. at 154 (finding an ordinance that prohibited canvassers from "going in and upon" private residential property to promote any cause without first obtaining a permit from the mayor's office and completing and signing a registration form or be subject to a misdemeanor was a violation of First Amendment).

55 *E.g.*, Murdock v. Pennsylvania, 319 U.S. 105, 106 (1943); Jamison v. Texas, 318 U.S. 413, 416 (1943); Lovell v. Griffin, 303 U.S. 444, 448 (1938); *Cantwell*, 310 U.S. at 301–02.

contributions.[56] The cases also reaffirmed that the distribution of handbills or information for religious purposes did not become a commercial activity simply because it was combined with a solicitation of funds or the sale of something, such as a book, but remained protected speech.[57]

Though protecting the speech interests of solicitation, the Court conceded that the "collection of funds" might be subject to reasonable regulation to protect the citizen against crime and undue annoyance, but the First Amendment required such controls to be drawn with "narrow specificity."[58] Although the earlier cases emphasized that First Amendment principles apply to charitable solicitation whether contained within a request for money or a purchase of a religious or political tract, the Court recognized the legitimate interests that a town or other governmental unit had in some form of regulation to protect its citizens, their property, and their right to privacy, particularly when the solicitation of money was involved.[59] There was a need to balance between these state interests and the effect of the regulations on First Amendment rights.[60]

Most earlier cases rested on the discretion of officials to issue a permit allowing door-to-door solicitation by religious individuals distributing information and disseminating ideas.[61] Door-to-door solicitation, as the Court observed, is essential to the "poorly financed causes of little people."[62] This Article suggests there is a need to recalibrate that balance between government and solicitors to reflect that modern fundraising is overwhelmingly not in person, door to door by "little people" but through sophisticated telemarketing firms on behalf of charities. Today, the "little people" needing protection are the recipients of the requests—that is, the public.

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56 *Martin v. Struthers*, for example, dealt with Jehovah's Witnesses who had gone door-to-door with invitations to a religious meeting despite a local ordinance prohibiting distribution of any "handbills, circulars or other advertisements" door-to-door. 319 U.S. at 142–44. The Court noted that such an ordinance "limits the dissemination of knowledge" and that it could "serve no purpose but that forbidden by the Constitution, the naked restriction of the dissemination of ideas." *Id.* at 144, 147.

57 Thomas v. Collins, 323 U.S. 516, 533 (1945); *Murdock*, 319 U.S. at 111–12; *Jamison*, 318 U.S. at 416; *Largent*, 318 U.S. at 420–22.

58 *Schaumburg*, 444 U.S. at 631; *Hynes*, 425 U.S. at 617, 619.

59 *Watchtower*, 536 U.S. at 164–65; *Martin*, 319 U.S. at 144; *Cantwell*, 310 U.S. at 306. The Court noted that if the provision in *Watchtower* had been "construed to apply only to commercial activities and the solicitation of funds, arguably the ordinance would have been tailored to the Village's interest in protecting its residents' privacy and preventing fraud." *Watchtower*, 536 U.S. at 165. The ordinance unquestionably applied to noncommercial canvassers. *Id.*

60 *Watchtower*, 536 U.S. at 163.

61 *See id.* at 159–60.

62 *Id.* at 163 (quoting *Martin*, 319 U.S. at 144–46).

B. *Cost of Fundraising as a Limit to Charitable Solicitation*

Efforts by state governmental bodies to regulate charitable solicitation resemble a kind of guerrilla warfare in which there are no final victories or defeats. After each judicial setback, a new initiative or approach is introduced. The flashpoint of regulatory scrutiny of charitable solicitation became the cost to the charity of its fundraising efforts upon hiring professional solicitors on a contingent fee basis. In contingent fee fundraising, the charity pays little or nothing up front, but the solicitor receives a percentage of every dollar donated.[63]

State legislators moved from unsuccessful attempts to prohibit solicitation through door-to-door canvassing to enacting legislation that allowed charities to spend only a specified maximal amount on fundraising expenses, with some exceptions, to qualify for a license to solicit.[64] The theory behind cost-of-fundraising regulation is that such limits ensure charitable dollars are spent primarily on an organization's charitable mission. A charity's cost of fundraising is usually expressed as a ratio defined as the cost of raising a certain amount in a solicitation campaign divided by the total amount raised.[65] More established charities are likely to have a lower cost-of-fundraising ratio ("CFR") because they can obtain contributions regularly from previous donors who are familiar with their missions and their reputations make them more attractive than newer sources of support. For example, a university might receive grants from foundations, governments, or other supporters and annual contributions from alumni to endow everything from buildings to bathrooms.[66]

There is distaste and distrust between more established charities and competing organizations that raise money for similar causes using less efficient means such as mass mailings and telemarketing.[67] Established charities have supported greater regulation of their newer or less prestigious competitors, and the focus has been on their cost of fundraising as an indicator of waste or fraud.[68] They also hoped that cost-of-fundraising regulation would

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63 NEW YORK STATE OFFICE OF THE ATTORNEY GENERAL, *supra* note 21, at 2.

64 *See, e.g.*, Riley v. Nat'l Fed'n of the Blind of N.C., Inc., 487 U.S. 781, 788–89 (1988).

65 The ratio is expressed as a total percentage of contributions received by the charity. *See* ASS'N OF FUNDRAISING PROFESSIONALS, MEASURING AND REPORTING FUNDRAISING COSTS: GUIDELINES FOR BOARD MEMBERS (2004), http://www.afpnet.org/files/AFP%20Chapters/CN4/MeasuringandReporting FundraisingCosts%20AFPCC.pdf. If a charity receives $10,000 in contributions from a solicitation but spends $8,000 for a professional solicitor and associated costs, the cost of fundraising is $8,000/$10,000 or 80 percent.

66 In the men's room of the Van Pelt Library of the University of Pennsylvania, a urinal is endowed by an alumnus with a plaque: "The relief you are now experiencing is made possible by a gift from [name of alumnus]."

67 *See* Espinoza, *supra* note 7, at 665.

68 *Id.* at 654–55.

drive out of business unsavory competitors that relied exclusively on mass solicitation techniques.[69]

Traditional or entrenched charities reasonably believe they are harmed when charitable dollars are not used for their intended purposes.[70] Generous donors, whose contributions have been diverted, may give less in the future. Government grant makers, whose tax dollars are wasted, may cut programs or support. Rightful beneficiaries of charities that use excessively paid solicitors may be denied services. Furthermore, the charitable sector as a whole may be damaged if the public loses faith in its probity.

Regulators assume that charities with high fundraising costs are more likely to engage in fraud, excessive profit taking, and waste.[71] However, a higher CFR may also indicate a charity of a different type than traditional nonprofits. The organization may be recently formed. Its appeal may be for a new or controversial cause, or its primary goal may not be to raise substantial funds but to transmit an educational message, perhaps unpopular with the public. It may solicit small donors through mass mailings rather than from funding sources accessible to more established organizations. It may be more difficult for a new charity to raise a dollar from a small donor than for an established nonprofit to receive $1,000 from a previous contributor. A newly formed charity has few disincentives to continual fundraising. Assume a charity spends 90 percent of every dollar raised to pay for the cost of its solicitation; the 10 percent remaining is still ten cents more than the organization possessed before the solicitation.

The belief that increased competition by charities with a high CFR impacts the fundraising of more established organizations in the same field has not been proved empirically. More likely, the cost is that some donors are misled by names similar to well-established organizations or by an emotive word in the name, such as "cancer," "children," or "veterans." Established charities' fundraising *should* be more efficient than newer charities that must spend a greater percentage of the dollars raised to gain recognition and support for their mission.

C. *The Fallacy of Cost-of-Fundraising Ratios*

A high CFR, though controversial, does not of itself indicate that a nonprofit is mismanaged, corrupt, or inefficient. CFR should be but one piece of data used to evaluate a charity. As stated above, a nonprofit's CFR may be high for a number of legitimate reasons. Other factors such as salaries and administrative costs, quantitative measures of mission attainment, and the number of people actually served by the charity compared to other organizations in the same field may be more important than CFR.

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69 *Id.*

70 *Id.* at 654.

71 *Id.* at 646.

A low CFR may not indicate the ethical high ground of reasonable fundraising costs. Organizations may have an acceptable CFR yet use their funds wastefully. The Wounded Warrior Project, the country's largest and, until recently, fastest growing veterans' charity, had a CFR of 40 percent, which is within the acceptable level, though at the higher end.[72] However, the organization spent millions of the $372 million raised in 2015 on staff travel, lavish dinners, hotels, and conferences and hundreds of thousands of dollars on public relations and lobbying.[73]

Established charities are sensitive to their own CFRs being perceived as too high and have adopted several approaches to minimize such expenses: shaving the actual fundraising costs in their publicity, hiding the costs through allocation to other expense categories, or denying that they have any such costs at all. The Red Cross claimed on its website and in public comments by top executives that ninety-one cents of each dollar donated went directly to services—meaning only nine cents of every dollar committed was spent on fundraising.[74] A review of financial statements showed that

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72 Dave Philipps, *Wounded Warrior Project Spends Lavishly on Itself, Insiders Say*, N.Y. TIMES (Jan. 27, 2016), http://www.cbsnews.com/heroes/.

73 *Id.* Former employees accused the Wounded Warrior Project ("WWP") of high overhead and wasteful expenditures. *Id.* Some of the programs were of questionable effectiveness. WWP spent 80 percent of donations on programs, but it arrived at that figure through counting some marketing material as educational. *Id.* The two top officers were forced out. Vaughn E. James, *Restructuring Coming for Wounded Warrior Project*, NONPROFIT L. PROF BLOG (Aug. 17, 2016), http://lawprofessors.typepad.com/nonprofit/2016/08/restructuring-for-wounded-warrior-project.html. The board instituted a review of the organization. *Id.* It remains to be seen when, if ever, the organization will recover from the scandal.

In May 2017, Senator Charles Grassley, Chairman of the Senate Committee on the Judiciary, released an investigative report that concluded the WWP was taking steps to remedy its questionable spending practices, but there remained questionable cost allocation issues. *See* Memorandum from Sen. Charles E. Grassley, Chairman, S. Judiciary Comm., to Members of the S. Comm. on Judiciary and Fin. (May 24, 2017), https://www.grassley.senate.gov/sites/default/files/constituents/2017-05-24%20CEG%20to%20Judiciary%20and%20Finance%20%28Wounded%20Warrior%20Project%29_final.pdf.

The senator offered recommendations as to how the organization can be more transparent and honest about its finances and better oversee its spending. *Id.* at 13. WWP claimed that 80.6 percent of donations were spent on programs for veterans, but the amount included promotional items, donated media and other costs that should have been characterized as program service expenses. *Id.* at 1–2. For IRS reporting purposes, donated media are not a program expense. Without including these figures, the organization spent an estimated 54–60 percent of donations helping wounded service members. *Id.* at 2–3. WWP averred that it spent more than $40 million in fundraising in FY 2014 that was educational in nature and therefore program services. *Id.* at 2. This was questionable under Financial Accounting Standards Board Statement of Position 98-2, "Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities that Include Fundraising." *Id.* at 9. WWP also stated it spent $65.4 million on long-term support programs. Grassley, *supra*, at 4. In actuality, the organization transferred the funds to a long-term support trust, whose only expenditure was for investment management fees. *Id.* at 6.

74 Jesse Eisinger, Justin Elliott & Laura Sullivan, *The Red Cross CEO Has Been Serially Misleading About Where Donors' Dollars Are Going*, PROPUBLICA (Dec. 4, 2014, 9:23 AM), http://www.propublica.org/article/red-cross-ceo-has-been-misleading-about-donations.

fundraising costs averaged seventeen cents per donated dollar during the previous five years.[75] One year, its CFR was twenty-six cents of every donated dollar.[76]

CFRs can be manipulated or even hidden by allocating expenses into more donor-acceptable categories, "such as public education, program services, general expenses, or administration instead of fundraising."[77] If a charity contracts with a professional fundraiser agreeing that any funds received by the charity will be after expenses and costs have been taken out by the fundraiser, can the charity validly claim that it has no fundraising costs? Two studies, several years apart, found that a substantial percentage of charities reported on their Form 990 annual informational tax return that they incurred no fundraising costs, while state filing records revealed that in fact the organization spent substantial amounts on solicitation.[78]

The first study by the Urban Institute's Center on Nonprofit and Philanthropy and the Center on Philanthropy at Indiana University examined 2000 tax year data and "found that more than a third of nonprofit groups that collected $50,000 or more" in contributions "claimed on their Form 990 that they spent nothing on fundraising, even though that was often not true."[79] The researchers "examined the tax returns of more than 125,000 nonprofit groups, and conducted surveys of overhead costs and accounting practices at 1,500 of them."[80] They "concluded that many groups that receive the best ratings from watchdog groups [were] not as efficient as they [seemed], and that many charities [lacked] the capacity to track" fundraising costs accurately.[81]

Another study (involving [2010] Form 990 returns conducted by the Scripps Howard News Service) of 37,987 charities and other nonprofits that raised at least $1 million through fundraising found that 41 percent of the charities (15,389) receiving a total of $116.7 billion stated they spent nothing for advertising, telephone solicitations, mailed appeals, professionally prepared grant applications or staff time for face-to-face solicitations.[82] "Forty-eight of Goodwill Industries' 127 major affiliates reported raising $387

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75 *Id.*

76 *Id.* For a critique of the Red Cross's work in disaster relief and its emphasis on publicity and "diverting assets for self-promotion," see Editorial Board, *Getting Help to Harvey's Victims*, N.Y. TIMES, Aug. 30, 2017, at A22.

77 FISHMAN, SCHWARZ & MAYER, *supra* note 31, at 247–48.

78 *Id.*

79 *Id.* at 248; *see also* URBAN INST., CTR. ON NONPROFITS & PHILANTHROPY & IND. UNIV., CTR. ON PHILANTHROPY, WHAT WE KNOW ABOUT OVERHEAD COSTS IN THE NONPROFIT SECTOR 1 (2004), https://philanthropy.iupui.edu/files/research/nonprofit_overhead_brief_1.pdf [hereinafter URBAN INST.].

80 FISHMAN, SCHWARZ & MAYER, *supra* note 31, at 248; URBAN INST., *supra* note 79, at 1.

81 FISHMAN, SCHWARZ & MAYER, *supra* note 31, at 248; URBAN INST., *supra* note 79, at 2.

82 *Study: Many Nonprofits Misreporting Solicited Donations*, 10NEWS.COM (May 14, 2012, 11:51 PM), https://www.10news.com/news/study-many-nonprofits-misreporting-solicited-donations [hereinafter 10NEWS Study].

million" with no fundraising costs.[83] The 22,598 organizations reporting fundraising expenses claimed an average cost of fundraising of only seven cents for every dollar contributed—an unbelievably low figure.[84] Robert Ottenhoff, former CEO of GuideStar and the Public Broadcasting Service, said: "It is ridiculous to think an organization could raise significant amounts of money without spending money to do it. I must be doing something wrong. I've never seen it growing on trees."[85]

Normally, nonprofit organizations allocate expenditures functionally—typically, program service expenses, management and general administrative expenses, and fundraising expenses.[86] These programmatic allocations reflect general accounting principles.[87] They are also desired by donors and required by governmental agencies such as the IRS in the Form 990 Annual Information Return, one part of which mandates that any § 501(c)(3) or § 501(c)(4) organization present a statement of functional expenses.[88] Failing to have such a standard is at best a softcore sort of fraud or misrepresentation.

Because the rules for determining overhead costs such as CFR are vague, and every charity seems to interpret them differently, some charity watchdogs, such as the BBB Wise Giving Alliance, Guidestar, and Charity Navigator, have criticized the emphasis on overhead ratios or cost of fundraising, and suggest that donors should focus on the charity's effectiveness measured by the impact of the organization on its beneficiaries—a much

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83 *Id.*

84 FISHMAN, SCHWARZ & MAYER, *supra* note 31, at 248.

85 10NEWS Study, *supra* note 82.

86 FIN. STATEMENTS OF NOT-FOR-PROFIT ORG., Statement of Financial Accounting Standards No. 117, ¶ 26 (Fin. Accounting Standards Bd. 1993).

87 *See* AM. INST. OF CERTIFIED PROF'L ACCTS, Statement of Position 98-2: Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising, 20,411 (Mar. 11, 1998). SOP 98-2 establishes accounting standards to ensure nonprofit organizations accurately state the amount of fundraising and other costs. This requires allocation of fundraising costs even if they are a joint activity with a programmatic or administrative function. If the fundraising cannot be reasonably allocated in part to another functional classification, it should be reported as fundraising costs. *Id.*

88 IRS Form 990, Return of Organization Exempt from Income Tax (OMB No. 1545-0047) (2016).

more difficult task.[89] Charity Navigator has deemphasized overhead in its ratings.[90] Other watchdogs disagree.[91]

One can assume charities that have extraordinarily high fundraising costs over many years are less effective and more likely to have issues of waste or fraud.[92] At some point, does a high CFR over many years indicate the charity is serving a private purpose, which would make the organization ineligible for tax exemption? Though every fundraising campaign tries to include some educational speech, which is protected, after years of high CFR and little expenditure on mission, should this indicate the speech component is merely formulaic, or even deceptive rather than meaningful, and demonstrates that no one is listening?

D. *Constitutional Limits to Cost-of-Fundraising Regulation: The Supreme Court Trilogy*

Three cases involving maximal allowable fundraising statutes reached the Supreme Court.[93] All were declared unconstitutional because they were

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89 GuideStar, *BBB Wise Giving Alliance, Charity Navigator, and GuideStar Join Forces to Dispel the Charity "Overhead Myth,"* (June 17, 2013), https://www.guidestar.org/Articles.aspx?path=/rxa/news/news-releases/2013/2013-06-17-overhead-myth.aspx. Less than two weeks after publication of the "America's Worst Charities" report, BBB Wise Giving Alliance, Charity Navigator, and Guidestar, three charity rating organizations, commenced a campaign to persuade donors to look beyond overhead costs when deciding which groups to support because overhead is a poor measure of a charities' performance. Suzanne Perry, *3 Major Charity Groups Ask Donors to Stop Focusing on Overhead Costs*, CHRON. PHILANTHROPY (June 17, 2013), http://philanthropy.com/article/3-Major-Charity-Groups- Ask/139881/?cid=pt&utm_source=pt&utm_medium=en. The statement concedes that "'at the extremes,' high spending on overhead can tip off donors to fraud or poor financial management." *Id.* The three organizations did not invite a fourth watchdog, CharityWatch to participate, because it rates charities exclusively on their financial performance. *Id.*

The Revised Principles for Good Governance and Ethical Practice ("Principles") provide more flexibility for overhead costs. Previously, the Principles stated that charities should spend a significant amount of their expenses on programs with a target of 65 percent of expenses. Alex Daniels, *New Charity Guidelines Deal with Online Fraud, Overhead, and Executive Pay*, CHRON. PHILANTHROPY (Feb. 25, 2015), https://philanthropy.com/article/New-Charity-Guidelines-Deal/227877. The revision says spending 65 percent of expenses on program activities and more on overhead is sometimes necessary. *Id.*

90 Ann Carrns, *Charity Navigator Tweaks Its Rating System*, N.Y. TIMES (May 27, 2016), https://www.nytimes.com/2016/05/28/your-money/charity-navigator-tweaks-its-rating-system.html?mcubz=0.

91 Suzanne Perry, *Overhead Costs Pose Dilemma for Charities*, CHRON. PHILANTHROPY (May 19, 2013), http://philanthropy.com/article/Overhead-Costs-Pose-Dilemma/139329/.

92 *See* Perry, *supra* note 89; Tim Ogden, *The Worst (and Best) Way to Pick A Charity This Year: Experts Explain that Overhead Ratios and Executive Salaries Are a Red Herring*, PHILANTHROPY ACTION, (Dec. 1, 2009), http://philanthropyaction.com/documents/Worst_Way_to_Pick_A_Charity_Dec_1_2009.pdf.

93 Riley v. Nat'l Fed'n of the Blind of N.C., Inc., 487 U.S. 781, 801 (1988) (holding certain licensing and disclosure provisions of state law unconstitutional); Sec'y of State of Md. v. Joseph H. Munson Co.,

overly broad and impinged on constitutionally protected speech.[94] In reaching this conclusion, the Supreme Court applied a standard of strict scrutiny to state regulatory efforts.[95]

1. Schaumburg v. Citizens for a Better Environment[96]

The Village of Schaumburg, Illinois enacted an ordinance prohibiting door-to-door or on-street solicitation of contributions by charitable organizations that did not use at least 75 percent of their receipts for charitable purposes.[97] Such purposes excluded cost of solicitation, salaries, overhead, and other administrative expenses.[98] After the Village denied a solicitation permit to Citizens for a Better Environment ("CBE"), a nonprofit environmental-protection organization, because it could not meet the ordinance's 75 percent requirement, CBE sued in federal district court, alleging that such a requirement violated the First and Fourteenth Amendments, and sought declaratory and injunctive relief.[99]

The legal issue was "whether the Village [had] exercised its power to regulate solicitation in such a manner" that did not intrude on the rights of free speech.[100] The district court granted summary judgment for CBE,[101] and

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467 U.S. 947, 970 (1984) (holding that a statute with a percentage restriction on charitable solicitation unconstitutionally limited the First Amendment right of charities to solicit); Schaumburg v. Citizens for a Better Env't, 444 U.S. 620, 639 (1980) (holding an ordinance prohibiting door-to-door canvassing for charitable contributions by charities not using at least 75 percent of receipts for "charitable purposes" unconstitutionally overbroad), *reh'g denied*, 445 U.S. 972 (1980).

94 The overbreadth doctrine holds that a law may be invalidated on grounds that it is overbroad—that is, the statute or ordinance sweeps within its coverage too much. It is an exception to two traditional rules of constitutional litigation. First, it results in the invalidation of a law 'on its face' rather than 'as applied' to a particular speaker. Ordinarily, a particular litigant claims that a statute is unconstitutional as applied to him or her; if the litigant prevails, the courts carve away the unconstitutional aspects of the law by invalidating its improper application on a case-by-case basis. If a law restricting speech is invalidated as applied to a protected speaker, it is held inapplicable to that speaker, and thus, in effect, judicially trimmed down. KATHLEEN M. SULLIVAN & NOAH FELDMAN, CONSTITUTIONAL LAW 1278 (18th ed. 2013).

When a statute is invalidated for overbreadth, it is unenforceable unless it is rewritten by the legislature or construed more narrowly. *Id.* Second, the overbreadth doctrine is an exception to the normal rule of standing that requires challengers to a law to assert their own interests, rather than those of third parties. *Id.* The overbreadth doctrine allows challengers to assert the rights of third parties, who may be reluctant to assert their own rights. *Id.*

95 *Riley*, 487 U.S. at 796.

96 444 U.S. 620 (1980).

97 *Id.* at 622–24.

98 *Id.* at 624.

99 *Id.* at 625.

100 *Id.* at 633.

101 *Id.* at 626.

the U.S. Court of Appeals for the Seventh Circuit affirmed.[102] The Seventh Circuit "concluded that even if the 75-percent requirement might be valid as applied to other types of charitable solicitation, the Village's requirement was unreasonable on its face because it barred solicitation by advocacy-oriented organizations even 'where . . . the contributions [would] be used for reasonable salaries of those who [gathered] and disseminate[d] information relevant to the organization's purpose.'"[103]

The Supreme Court affirmed the Seventh Circuit's holding that the ordinance in *Schaumburg* was constitutionally overbroad and violated the First and Fourteenth Amendments.[104] It reviewed prior cases which established that charitable appeals for funds involved a variety of speech interests within the protection of the First Amendment.[105] Though solicitation was "subject to reasonable regulation," such regulatory efforts had to "be undertaken with due regard for the reality that [it was] characteristically intertwined with informative and perhaps persuasive speech seeking support for particular causes or for particular views on economic, political, or social issues, and for the reality that without solicitation the flow of such information and advocacy would likely cease."[106] Additionally, since "charitable solicitation [did] more than inform private economic decisions and [was] not primarily concerned with providing information about the characteristics and costs of goods and services," it could not be considered "a variety of purely commercial speech."[107]

The ordinance at issue in *Schaumburg* would be unconstitutionally applied to advocacy organizations that not only compensated solicitors but also paid others to obtain, process, and disseminate the organization's positions on items of interest.[108] Such organizations would necessarily spend more than the 25 percent limit on solicitation costs, and such information and advocacy would likely cease.[109] "[U]nless it serve[d] a sufficiently strong, subordinating interest that the Village [was] entitled to protect," the ordinance could not

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102 *Schaumburg*, 444 U.S. at 627.

103 *Id.* (quoting Citizens for a Better Env't v. Schaumburg, 590 F.2d 220, 226 (7th Cir. 1978)). The Seventh Circuit distinguished this from *National Foundation v. Fort Worth*, 415 F.2d 41 (5th Cir. 1969), *cert. denied*, 396 U.S. 1040 (1970) (upholding a Fort Worth ordinance denying solicitation permits to organizations with CFRs exceeding 20 percent of gross receipts).

104 *Schaumburg*, 444 U.S. at 636. Note that for purposes of the overbreadth doctrine, the Court held the appellate tribunal was "free to inquire whether [the ordinance] was overbroad, a question of law that involved no dispute about the characteristics of CBE." *Id.* at 634. Even if there was no demonstration that CBE was one of the organizations affected, the ordinance purported to prohibit a substantial category of charities to which the 75 percent limitation could not be applied consistently with First and Fourteenth Amendment principles. *Id.* at 636.

105 *Id.* at 632.

106 *Id.*

107 *Id.* The fact that speech was in the form of a solicitation to pay or contribute money did not affect its protection.

108 *Schaumburg*, 444 U.S. at 635.

109 *Id.*

be sustained.[110] The village's justification of "'protecting the public from fraud, crime, and undue annoyance' . . . could be sufficiently served by measures less destructive of First Amendment interests" and more narrowly drawn.[111]

The Supreme Court seemed to agree with the exception carved out by the Seventh Circuit for organizations "whose primary purpose [was] not to provide money or services for the poor, the needy or other worthy objects of charity, but to gather and disseminate information about and advocate positions on matters of public concern."[112] Such organizations may pay reasonable salaries, which by the nature of their work would exceed the 25 percent CFR limit in the statute.[113] Thus, the ordinance unjustifiably infringed First and Fourteenth Amendment rights.[114] The Court seemed to accept that CFR limits might be enforceable against more traditional charitable organizations' purely commercial solicitations.[115]

The *Schaumburg* decision did not ignore the interests of the community or state in protecting its citizens from fraud, preventing their access to property, or protecting their rights of privacy.[116] The Court suggested that more narrow means than a direct prohibition based on CFR might fulfill the Village's interest in preventing fraud.[117] These included denouncing frauds and criminal offenses via punishment through the penal laws; "permitting homeowners to bar solicitors from their property by posting signs reading 'No Solicitors or Peddlers Invited'"; and efforts by the Village and the state of Illinois to promote disclosure of charities' finances and thus inform potential donors about how their contributions will be employed.[118]

As Justice Rehnquist pointed out in his dissent, *Schaumburg* differed from its precedents, a plurality of which turned on the discretion of the licensing authority to issue a permit.[119] Others "involved the distribution of information, as opposed to requests for contributions."[120] He noted that from a practical standpoint, the decision offered "no guidance as to how a municipality might identify those organizations 'whose primary purpose is . . . to gather and disseminate information about and advocate positions on matters of public concern.'"[121] This, in fact, has become a problem: a dollop of speech in a sea of the commercial seeking of funds tilts to the constitutionally

110 *Id.* at 636.
111 *Id.*
112 *Id.* at 635.
113 *Id.* at 635.
114 *Schaumburg*, 444 U.S. at 635–36.
115 *See id.* at 635, 637.
116 *Id.* at 636.
117 *Id.* at 636–37.
118 *Id.* at 637–39.
119 *Id.* at 640 (Rehnquist, J., dissenting).
120 *Schaumburg*, 444 U.S. at 640.
121 *Id.* at 642 (alteration in original).

protected side of the equation, thereby offering broad access to deceptive fundraising.

Furthermore, by categorizing a solicitation as protected speech, *Schaumburg* seemed to subject such attempts to regulate this activity to a strict scrutiny standard of review; but this interpretation of the decision is ambiguous. To pass the strict scrutiny standard, a legislature must have passed the particular law under review to further a "compelling governmental interest" and must have narrowly tailored the law to achieve that interest.[122]

Schaumburg created at least three ambiguities that subsequent cases resolved. The first was the distinction between traditional charitable organizations providing services, which seemingly could be limited by a CFR requirement, and advocacy organizations that could not be so restricted.[123] Second, what level of scrutiny should a court apply to legislation that limited the amount of funds an organization could spend on fundraising expenses?[124] *Schaumburg* was unclear whether such statutes should receive intermediate or strict scrutiny review. As Professor John Inazu has demonstrated, in the aftermath of *Schaumburg*, the federal courts were all over the lot.[125] A third ambiguity was whether giving a state official authority to waive the flat CFR mandate could rectify the deficiency of the ordinance in *Schaumburg*.[126] Uncertainty as to the standard of scrutiny given to statutes regulating CFR solicitation was corrected in *Secretary of State of Maryland v. Joseph H. Munson Co.*[127] and *Riley.*

2. Secretary of State of Maryland v. Joseph H. Munson Co.

Munson involved a Maryland statute prohibiting solicitations by any charity that did not use 75 percent of its receipts for charitable purposes, the same percentage limitation as the ordinance in *Schaumburg*.[128] However, the Maryland statute authorized a waiver of this limitation where it would effectively prevent the organization from raising contributed funds.[129] The issue in

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122 Strict scrutiny is a form of judicial review that courts use to determine the constitutionality of certain laws. *See infra* Section V.B (discussing the levels of scrutiny).

123 *See Schaumburg*, 444 U.S. at 635–36.

124 Inazu, *supra* note 7, at 565–67.

125 *Id.* at 565–66.

126 Sec'y of State of Md. v. Joseph H. Munson Co., 467 U.S. 947, 962 (1984).

127 467 U.S. 947 (1984).

128 *Id.* at 950 (citing MD. CODE ANN., § 41-103D (1982)).

129 The waiver section of the statute read as follows:

> The Secretary of State shall issue rules and regulations to permit a charitable organization to pay or agree to pay for expenses in connection with a fund-raising activity more than 25 [percent] of its total gross income in those instances where the 25 [percent] limitation would effectively prevent the charitable organization from raising contributions.

MD. CODE ANN. § 41-103D(a) (1982).

Munson was whether the addition of an administrative waiver of the limitation enabled the ordinance to withstand constitutional attack.[130]

The Joseph H. Munson Company, Inc. was a professional fundraiser that promoted fundraising events and gave advice on how they should be conducted.[131] Among Munson's clients were several Maryland chapters of the Fraternal Order of Police.[132] Munson usually charged more than 25 percent of the gross raised for the events it promoted.[133] One of its clients was reluctant to contract with the company because of the percentage limitation.[134] Munson brought suit claiming that the Maryland Secretary of State threatened it with prosecution if the company refused to comply with the statute, and that the percentage limitation would violate the rights of free speech of Munson's clients under the First and Fourteenth Amendments.[135] The lower Maryland courts upheld the statute,[136] but the Maryland Court of Appeals found it was not a narrowly drawn regulation designed to serve the state's legitimate interests without interfering with First Amendment freedoms.[137]

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130 *Munson*, 467 U.S. at 962.

131 *Id.* at 950.

132 *Id.*

133 *Id.* at 950–51.

134 *Id.* at 954.

135 *Id.* at 950–51. Another issue in the case was whether Munson as a third party, rather than Maryland charities that were the direct entities regulated by the Maryland statute, had standing to challenge the percentage limitation. *Munson*, 467 U.S. at 954. Any litigant "must satisfy . . . the 'case' or 'controversy' requirement of [Article] III of the United States Constitution." *Id.* (citing Singleton v. Wulff, 428 U.S. 106, 112 (1976)). The "case or controversy" requirement of Article III restricts federal courts to the resolution of concrete disputes between the parties before them, rather than hypothetical situations. *Id.* at 976 (Rehnquist, J., dissenting). "Because its contracts [called] for payment in excess of 25 [percent] of the funds raised for a given event," Munson suffered potential civil and criminal liability. *Id.* at 954 (majority opinion). As mentioned in the text, one of its clients was reluctant to enter a contract because of the percentage limitation, and Munson had been informed it "would be prosecuted if it failed to comply with the . . . statute." *Id.* at 951. The Court found that Munson satisfied the case or controversy requirement because it was threatened with actual and threatened injury as a result of the statute. *Id.* at 954–55. "In addition to the limitations on standing . . . 'plaintiff[s] generally must assert [their] own legal rights"' and not the rights of third parties. *Munson*, 467 U.S. at 955. Where the claim is that the statute is overly broad in violation of the First Amendment and the "statute is directed at persons with whom the plaintiff has a business or professional relationship, and impairs the plaintiff in that relationship, [the plaintiff] normally is accorded standing to challenge the validity of the statute," although Munson's own activities were not constitutionally protected. *Id.* at 953. The existence of the statute could chill its challenge by primary parties for fear of punishment. The Court cited *Schaumburg*, 444 U.S. 634. Note that though Munson was the plaintiff in the lower court cases, because the Secretary of State appealed the highest Maryland court's decision, Munson became the respondent in the Supreme Court case. *Id.* at 952. Justice Stevens in a concurring opinion felt that "while the writ of certiorari should have never issued in this case, there [were] sufficient reasons for finding that Munson's 'third party' standing [was] proper." *Id.* at 973 (Stevens, J., concurring).

136 *Id.* at 952 (majority opinion).

137 Joseph H. Munson Co. v. Sec'y of State, 448 A.2d 935, 946 (1982) (citing Schaumburg v. Citizens for a Better Env't, 444 U.S. 620, 637 (1980)), *aff'd*, 467 U.S. 947 (1984).

The Supreme Court rejected the assumption that a high CFR indicated a probability of fraud.[138] It recognized there were organizations with high fundraising costs unrelated to protected First Amendment activity, which could have their activities prohibited.[139] The problem with the Maryland statute was it could not "distinguish those organizations from charities that have high costs due to protected First Amendment activities."[140] The statute's flaw was that it "operate[d] on a fundamentally mistaken premise that high solicitation costs [were] an accurate measure of fraud."[141] Restricting solicitation costs may do nothing to prevent fraud.[142]

The Court denied the waiver option as a corrective to constitutional objections to the statute, stating that "[t]he possibility of a waiver may decrease the number of impermissible applications of the statute, but it does nothing to remedy the statute's fundamental defect"—namely, the imposition of a direct restriction on protected First Amendment activity.[143] "[T]he means chosen to accomplish the State's objectives [were] too imprecise . . . the fact that the [Maryland statute] regulate[d] all charitable fundraising, and not just door-to-door solicitation, [did] not remedy the fact that the statute promote[d] the State's interest only peripherally." [144]

In dissent, Justice Rehnquist challenged the majority's use of the overbreadth doctrine for allowing review by the defendant.[145] The dissent considered that the "Maryland statute function[ed] primarily as an economic regulation setting a limit on the fees charged by professional fundraisers," a differentiation from *Schaumburg*, which the dissent interpreted as primarily "controlling the nature and internal workings of charitable organizations seeking to solicit in the Village."[146] In *Schaumburg*, the statute's "prime failing was that it effectively prohibited any solicitation by 'organizations that [were] primarily engaged in research, advocacy, or public education and that use[d] their own paid staff to carry out those functions as well as to solicit financial support.'"[147] "Such advocacy organizations [were] likely to have high administrative expenses, which would [have made] it impossible for them to qualify for a permit."[148] In contrast, the Maryland statute was "primarily directed at controlling the external, economic relations between

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138 *Munson*, 467 U.S. at 961.

139 *Id.* at 966.

140 *Id.*

141 *Id.*

142 *Id.* at 967.

143 *Id.* at 968.

144 *Munson*, 467 U.S. at 968–69. Munson was a 5–4 decision with a concurrence by Justice Stevens. *Id.* at 975 (Rehnquist, J., dissenting).

145 *Id.* at 975 (Rehnquist, J., dissenting).

146 *Id.* at 978.

147 *Id.* at 978–79 (quoting Schaumburg v. Citizens for a Better Env't, 444 U.S. 620, 636 (1980)).

148 *Id.* at 979.

charities and professional fundraisers" and should be judged "under the minimum rationality standard traditionally applied to economic regulations."[149]

Justice Rehnquist's dissent found that the limitation on fundraiser's fees "serve[d] a number of legitimate and substantial governmental interests."[150] It "insure[d] that funds solicited from the public for a charitable purpose [would] not be excessively diverted to private pecuniary gain."[151] The limitation "encourage[d] the public to give . . . with confidence that money designated for a charity will be spent on charitable purposes."[152] Moderate fundraising fees "coincide[d] with the contributors' expectations that their contributions [would] go primarily to the charitable purpose" for which the funds were solicited and protected the charities themselves.[153]

3. Riley v. National Federation of the Blind of North Carolina, Inc.

In *Riley*, the state of North Carolina for the first time directly asserted an interest in "ensuring that the maximum amount of funds reach the charity."[154] This goal would be assisted by a three-tier sliding scale of permissible contingent fees.[155] The Court rejected the paternalistic view that charities could not negotiate fair and reasonable contracts without governmental assistance or decide for themselves the most effective way to exercise their First Amendment rights.[156] The speakers, not the government, knew best what to say and how to say it.[157]

North Carolina also maintained that the Act's flexibility, unlike in *Schaumburg* and *Munson*, was more narrowly tailored to state interests.[158] The Court rejected the distinction.[159] Permitting rebuttal of the CFR limits by the solicitor did not create a nexus between the percentages and the state's interest.[160] Even if a percentage-based measure could be used in part to detect fraud, the Court would not require the speaker to establish on a case-by-case basis that the fee was reasonable.[161]

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149 *Munson*, 467 U.S. at 979.

150 *Id.* at 980.

151 *Id.*

152 *Id.*

153 *Id.*

154 *Id.* at 789.

155 Fees not greater than 20 percent of gross receipts were presumed reasonable; fees between 20 percent and 35 percent were reasonable unless the challenging party could show that a particular solicitation campaign did not disseminate ideas or information; and fees over 35 percent were presumed unreasonable, subject to rebuttal by the professional solicitor. *Id.* at 784–86.

156 *Id.* at 790.

157 *Id.* at 790–91.

158 *Id.* at 792.

159 *Id.*

160 *Riley*, 487 U.S. at 793.

161 *Id.*

Riley rejected the point of disclosure of financial information.[162] The Court found that "[m]andating speech that a speaker would not otherwise make necessarily alters the content of the speech" and is therefore content-based regulation.[163] As a result, the statute was subject to exacting First Amendment scrutiny. The Court elaborated:

> Our lodestars in deciding what level of scrutiny to apply to a compelled statement must be the nature of the speech taken as a whole and the effect of the compelled statement thereon. This is the teaching of *Schaumburg* and *Munson*, in which we refused to separate the component parts of charitable solicitations from the fully protected whole. Regulation of a solicitation "must be undertaken with due regard for the reality that solicitation is *characteristically* intertwined with informative and perhaps persuasive speech . . . , and for the reality that without solicitation the flow of such information and advocacy would likely cease."[164]

The reality, however, is that many charitable solicitations are primarily commercial, and the speech components are an unimportant, if not formulaic, part of the pitch.

The state argued that the speech regulated was commercial because it concerned only the professional fundraisers' profit.[165] Therefore, the more deferential commercial speech standard should apply.[166] The Court responded that speech did not "retain[] its commercial character when inextricably intertwined" with fully protected speech.[167] But what if the commercial

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162 *Id.* at 795.

163 *Id.*

164 *Id.* at 796 (emphasis added) (quoting Schaumburg v. Citizens for a Better Env't, 444 U.S. 620, 632 (1980)).

165 *Id.* at 795.

166 *Riley*, 487 U.S. at 795. In 1976, commercial speech received First and Fourteenth Amendment protection, albeit at a lower level than fully protected speech. Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc., 425 U.S. 748, 761 (1976). Though an advertiser's interest in commercial advertisement was purely economic, this did not disqualify it from constitutional protection because both individual consumers and society in general may have strong interests in the free flow of commercial information. *Id.* at 762–64. In *Central Hudson Gas & Electric Corp. v. Public Service Commission*, 447 U.S. 557, 566 (1980), the Supreme Court established a four-pronged, somewhat vague test for permissible governmental restrictions on commercial speech: (1) the speech in question must be protected by the First Amendment; (2) the commercial speech must concern lawful activity and not be misleading; (3) the government's interest in restricting the speech must be substantial; and (4) the restriction must directly advance the government's asserted interest and must not be more extensive than necessary to serve the asserted government interest. The Court has upheld compelled disclosure when necessary to prevent speech that is false, is deceptive, is misleading, or proposes illegal transactions. Zauderer v. Office of Disciplinary Counsel of the Supreme Court of Ohio, 471 U.S. 626, 658 (1985). The *Central Hudson* test for commercial speech exemplifies "intermediate scrutiny" as applied. Robert Post, *Compelled Commercial Speech*, 117 W. VA. L. REV. 867, 881 (2015); Allen Rostron, *Pragmatism, Paternalism, and the Constitutional Protection of Commercial Speech*, 37 VT. L. REV. 527, 538 (2013). *But see* Sorrell v. IMS Health Inc., 564 U.S. 552, 566 (2011). This Article suggests not that charitable solicitation speech is merely, or should be considered under the doctrines of, commercial speech but only that the intermediate standard of review be applied to it.

167 *Riley*, 487 U.S. at 796.

component is not intrinsically intertwined? Aside from questions of First Amendment precedent, the Court's conclusion on mandated disclosure made practical sense. Just imagine the chances of success of a solicitation in which the solicitor says in the course of the pitch, "85 percent of the money raised goes to me or my firm."

In *Riley* the Court found that the justifications for CFR disclosure were not as weighty as the state asserted, and the means chosen, taken as a whole, were unduly burdensome, were not narrowly tailored, and endangered the freedom of protected speech.[168] The effect of the compelled statement of CFR changed the content of the speech.[169] The Court assumed that charitable solicitation was always intertwined with informative and even persuasive speech, and the spread of information and advocacy would decrease without the solicitation.[170] As a result, the content-based North Carolina statute was subject to exacting First Amendment principles—in other words, strict scrutiny.[171]

Chief Justice Rehnquist with Justice O'Connor in dissent considered the disclosure requirement as commercial speech and the statute as price control regulation.[172] They interpreted the statute as merely requiring that no professional fundraiser can charge an unreasonable fee.[173] Therefore, it had a small, indirect impact on speech.[174] Unlike fixed percentages in the other cases, here the statute determined reasonableness, and disclosure of the percentage was not a burden on speech.[175]

The Supreme Court's jurisprudence clearly demonstrates that charitable appeals for funds, on-the-street or door-to-door, involve a variety of speech interests—communication of information, the dissemination and propagation of views and ideas, and the advocacy of causes—that are within the protection of the First Amendment. The trilogy of cases refused to separate the speech involved into component parts of protected and unprotected. As the Court noted in *Schaumburg*:

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168 *Id.* at 798.

169 *Id.* at 795.

170 *See id.* at 796.

171 The statute's licensing requirement was unconstitutional because it required professional fundraisers to await a determination regarding their license application before engaging in solicitation, whereas volunteer fundraisers or those employed by the charity could solicit immediately upon submitting an application. *Id.* at 801–03. A speaker's rights were not lost just because compensation was received. The state's power to license professional fundraisers comes with it, unless properly constrained, the power to affect speech they utter. If a license is required, the regulation must state that the licensor "will, within a specified brief period, get the license or go to court." *Id.* at 802 (quoting Freedman v. Maryland, 380 U.S. 51, 59 (1965)). Here, the statute permitted a delay without limit. *Id.* at 802.

172 *Id.* at 807 (Rehnquist, C.J., dissenting).

173 *Riley*, 487 U.S. at 806.

174 *See id.* at 806–07.

175 *Id.* at 809–10.

> Soliciting financial support is undoubtedly subject to reasonable regulation but the latter must be undertaken with due regard for the reality that solicitation is characteristically intertwined with informative and perhaps persuasive speech seeking support for particular causes or for particular views on economic, political, or social issues, and for the reality that without solicitation the flow of such information and advocacy would likely cease. Canvassers in such contexts are necessarily more than solicitors for money. Furthermore, because charitable solicitation does more than inform private economic decisions and is not primarily concerned with providing information about the characteristics and costs of goods and services, it has not been dealt with in our cases as a variety of purely commercial speech.[176]

The Court's rejection of cost-of-fundraising regulation in the above three cases resulted in the demise of that regulatory approach, except through filing of such information with the state, which has occurred in many states and is often available to the public if it seeks the information on the internet.[177] Nevertheless, the Court offered some more narrowly tailored options: the state itself could publish the detailed filings of professional fundraisers, or it could enforce its antifraud laws.[178] The problem with the first option suggested, adopted in many states where the forms often are available on the internet, is that the public does not utilize the opportunity. The second suggestion is more flawed. Realistically, the cost of investigating and bringing suit pursuant to an allegation of fraud is so expensive and resource consumptive that only very few state attorneys general have the resources to engage in such litigation on a regular basis.[179]

Riley contains at least two misconceptions and one unintended consequence about charitable solicitation that do not reflect a substantial part of modern fundraising. First, the Court assumed that solicitation is always interwoven with protected speech.[180] As in the hypothetical solicitations discussed in this Article,[181] the protected speech component may be an insignificant formulaic part of the solicitation. For example, when a cancer charity

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176 Schaumburg v. Citizens for a Better Env't, 444 U.S. 620, 632 (1980).

177 *See Riley*, 487 U.S. at 796; Sec'y of State v. Joseph H. Munson Co., 467 U.S. 947, 959 (1984); *Schaumburg*, 444 U.S. at 632; *see also, e.g.*, Commercial Fundraiser Reports Search, STATE OF CALIFORNIA DEP'T OF JUSTICE, https://oag.ca.gov/charities/cfr-search.

178 *Riley*, 487 U.S. at 800.

179 *See* CINDY M. LOTT, ELIZABETH T. BORIS, KARIN KUNSTLER GOLDMAN, BELINDA J. JOHNS, MARCUS GADDY & MAURA FARRELL, STATE REGULATION AND ENFORCEMENT IN THE CHARITABLE SECTOR V–VI, 8 (2016). A recent survey of all state and U.S. territory offices with oversight, regulatory, and enforcement authority over charities found that there were only 355 state charity regulators nationwide (attorneys and other nonsupport staff) to carry out all these responsibilities. The survey found that most state charity offices have few staff to conduct their work and carry out their duties. Thirty-one percent of jurisdictions have less than one full-time equivalent staff, 51 percent have between 1 and 9.9 full-time equivalent staff, and 19 percent have ten or more full-time equivalent staff. As a result, state-level enforcement actions are more likely to be informal resolutions or involve correspondence with organizations or settlements than fines and penalties or other formal litigation such as injunctions.

180 *Riley*, 487 U.S. at 796.

181 *See* discussion *infra* Section IV.G (hypothetically reconfiguring *Riley* such that the soliciting organization has years of greater than 80 percent CFRs, high administrative expenditures, and generous staff compensation).

in the course of its pitch for money says, "Eating blueberries contains antioxidants to prevent cancer,"[182] this statement may be valid but should not of itself be sufficient protected speech interwoven with the solicitation to gain entry to the strict scrutiny category of review.

Second, the Court criticized the statute at issue in *Riley* for its paternalism to charities that can protect themselves and know what is in their best interest.[183] Rather, the focus should be on the protection of members of the public, who may not be as easily able to protect themselves. An unintended consequence of adopting strict scrutiny means almost all state charitable solicitation regulation that affects some speech will be rejected. In practice, what has happened is that, unless there are blatant allegations of fraud resulting from multiple complaints by the public, attorneys general are unlikely to pursue solicitation cases. However, fraudulent solicitation statements remain constitutionally unprotected.[184]

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182 The author, who has eaten blueberries in that belief for years, was chagrined to learn that it may not be so! *See* Gina Kolata, *We're So Confused: The Problems with Food and Exercise Studies*, N.Y. TIMES (Aug. 11, 2016), https://nyti.ms/2b7ZFZR.

183 *Riley*, 487 U.S. at 790–91.

184 Despite the holding in *Riley* finding the organization's solicitation protected speech, the Court suggested that the state can enforce its antifraud laws to prohibit professional fundraisers from obtaining money by false pretenses or by making false statements. *Id.* at 795. The Illinois attorney general sued a professional fundraiser for fraud, contending that the fundraiser knowingly misrepresented to donors that a significant amount of each dollar donated would be paid over to charity when in fact the fundraiser retained 85 percent of the gross receipts raised. Illinois *ex rel.* Madigan v. Telemarketing Assoc., Inc., 538 U.S. 600, 607 (2003). The Illinois Supreme Court dismissed the complaint, concluding that the state attempted to regulate the fundraiser's ability to engage in protected activity based on a percentage-rate limitation rejected in *Riley*. *Id.* at 606. In *Madigan*, the Supreme Court unanimously reversed. *Id.* at 624. Treating the case as a fraud action, the Court held that fraudulent charitable solicitation is unprotected speech, and the "states may maintain fraud actions when fundraisers make false or misleading misrepresentations designed to deceive donors about how their donations will be used." *Id.* at 612, 624. The Court distinguished fraud actions, which focus on representations made in individual cases, from statutes that categorically ban solicitations when fundraising costs run high. *Id.* at 619. In *Riley*, the statute did not depend on whether the fundraiser made fraudulent representations to potential donors. *Riley*, 487 U.S. at 784–85 (explaining that the statute merely prevented professional fundraisers from collecting unreasonable or excessive fees from the gross revenues raised at charitable solicitation events). The First Amendment, the Court stated in *Madigan*, did not require a "blanket exemption from fraud liability for a fundraiser who intentionally [misled] in calls for donations." *Madigan*, 538 U.S. at 621. The Court noted, however, that high fundraising costs by themselves or mere failure to voluntarily disclose the fundraiser's fee when soliciting potential donors do not establish fraud. *Id.* at 624.

III. REGULATION OF CHARITABLE SOLICITATION AFTER *RILEY*

A. *Case Developments*

In the aftermath of *Riley*, lower federal courts voided several state CFR statutes similar to North Carolina's, though some allowed mandated disclosure.[185] States have succeeded in expanding the scope of compelled point-of-disclosure in small ways. *Riley* opened the door for this when the Court said in dictum: "[N]othing in this opinion should be taken to suggest that the State may not require a fundraiser to disclose unambiguously his or her professional status. On the contrary, such a narrowly tailored requirement would withstand First Amendment scrutiny."[186] The Court suggested "more benign and narrowly tailored options."[187] It gave as an example that "the State may itself publish the detailed financial disclosure forms it requires professional fundraisers to file," which "would communicate the desired information to the public without burdening a speaker with unwanted speech during the course of a solicitation."[188] States have followed this guidance.[189]

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185 *See* Shannon v. Telco Commc'ns, Inc., 824 F.2d 150, 153 (1st Cir. 1987) (voiding a Massachusetts statute that limited a solicitor's compensation to 25 percent of receipts); Nat'l Fed'n of the Blind of Tex., Inc. v. Abbott, 682 F. Supp. 2d 700, 713 (N.D. Tex. 2010) (statute requiring companies that solicited and resold donations of clothing and other household items on behalf of charities to disclose the amount of money received by the charities and specify whether the sum was a set percentage or a flat fee was not narrowly tailored and was an unconstitutional restriction on speech although receptacles for donations were not staffed, and the solicitors rarely disclosed their names but used the name of a charity); Ky. State Police Prof'l Ass'n v. Gorman, 870 F. Supp. 166, 169 (E.D. Ky. 1994) (provision of Kentucky Consumer Protection Act prohibiting representation that a charity will be the recipient of funds if the professional solicitor has a contract allowing it to receive more than 50 percent of gross receipts was unduly burdensome and not narrowly tailored to state's interest in preventing fraud and, thus, violated the First Amendment); Ind. Voluntary Firemen's Ass'n v. Pearson, 700 F. Supp. 421, 447 (S.D. Ind. 1988) (striking down, in part, an Indiana statute that required both oral and written disclosures of the percentage of funds raised that were paid to the solicitor); Telco Commc'ns, Inc. v. Carbaugh, 700 F. Supp. 294, 298 (E.D. Va. 1988) (striking down a Virginia provision that required a point-of-solicitation disclosure of the minimal percentage of funds that would go to the charity), *aff'd in part and rev'd in part*, 885 F.2d 1225, 1227 (4th Cir. 1989), *cert. denied*, 495 U.S. 905 (1990); State v. Kelley, 541 N.W.2d 645, 654 (Neb. 1996) (statute requiring certification in a letter of approval from a county attorney before charitable solicitation was permitted outside the organization's home county constituted unconstitutional prior restraint, overbreadth, and vagueness); People v. French, 762 P.2d 1369, 1375 (Colo. 1988) (holding unconstitutional compelled disclosure by fundraisers if the charity retained less than 50 percent of gross receipts); WRG Enters., Inc. v. Crowell, 758 S.W.2d 214, 219 (Tenn. 1988) (striking down a compensation limit of 15 percent of gross receipts).

186 *Riley*, 478 U.S. at 799 n.11.

187 *Id.* at 800.

188 *Id.*

189 *See, e.g.*, Telco Commc'ns, Inc. v. Carbaugh, 885 F.2d 1225, 1231–32 (4th Cir. 1989) (solicitation code requiring professional solicitors to disclose in writing at the time of solicitation that a financial statement for the last fiscal year is available upheld as preventing fraud and not inherently incompatible

B. *Mandated Disclosure and Its Discontents*

Riley did not prohibit all regulation of charitable solicitation.[190] It held that "[t]he interest in protecting charities (and the public) from fraud is, of course, a sufficiently substantial interest to justify a narrowly tailored regulation."[191] The Court did not strike down the restrictions on fundraising fees to make states "sit idly by and allow their citizens to be defrauded."[192] It noted that North Carolina (and other states) could constitutionally impose certain financial disclosure requirements on fundraisers, as the state had been doing.[193]

In place of CFR regulation, many states turned to increased mandatory disclosure of financial and other information, not all of which is available to the public.[194] At the federal level, Form 990s, the annual information returns required by the IRS, became available online.[195] This provided substantial information for public scrutiny of all § 501(c)(3) tax-exempt organizations. Most states require charities to register their contracts with fundraisers, and a few publish the names of charities and professional solicitors that have particularly high percentages of fundraising costs in the eyes of regulators.[196]

Mandated disclosure is supposed to give individuals information for analyzing whether to contribute to a particular organization. This information should result in better decision-making.[197] Mandated disclosure assumes that

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with the First Amendment); Tennessee Law Enf't Youth Found. v. Millsaps, No. 89-2762-G, 1991 WL 523878 (W.D. Tenn. Sept. 3, 1991) (requirement that professional solicitors disclose in writing at the time of solicitation that a financial statement for the last fiscal year was available consistent with *Riley* based on a finding of a sufficient state interest in donor education); *see also* Famine Relief Fund v. West Virginia, 905 F.2d 747, 749–52 (4th Cir. 1990) (West Virginia provision requiring charitable expenditures to be "related in a primary degree to [the] stated purpose . . . in accordance with reasonable donor expectations" was constitutional, imposing no actual percentage-based limitations, and thus survived *Riley*). This was dictum because the court found the statute defective on independent due process grounds. *Id.* at 754.

190 *Riley*, 487 U.S. at 792.

191 *Id.*

192 *Id*. at 795.

193 *Id.*

194 Three states, Hawaii, California, and New York, have required the submission of Schedule B of the Form 990 Annual Information return, which lists substantial donors to the charity and is unavailable to the public, to be filed with the attorney general. HAW. REV. STAT. § 467B-6.5 (2008); Citizens United v. Schneiderman, 203 F. Supp. 3d 397, 400 (S.D.N.Y. 2016), *rev'd in part and aff'd in part,* 882 F.3d 274 (2018); Americans for Prosperity Found. v. Harris, 182 F. Supp. 3d 1049, 1052 (C.D. Cal. 2016), *rev'd sub nom.* Americans for Prosperity Found. v. Becerra, 903 F.3d 1000 (2018). Litigation challenging the California and New York regulations has so far been rather unsuccessful. *See Americans for Prosperity Found.*, 903 F.3d at 1011–18; *Citizens United*,882 F.3d at 383–88 (holding such regulations did not violate the First Amendment).

195 Form 990s of § 501(c)(3) charities are available on the internet at http://www.guidestar.org.

196 *See* NEW YORK STATE OFFICE OF THE ATTORNEY GENERAL, *supra* note 21, at 2.

197 *See* Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure*, 159 U. PA. L. REV. 647, 681–84 (2011).

the information available will reflect the quality of the charity's work and influence the potential donor's decision.[198] As the discussion of CFR suggested, there may be a weak correlation, if any, between a high CFR and inefficiency, waste, or fraud.[199] Assembling the data is subjective because the organization, not the regulator, allocates costs, and charities can juggle the numbers by assigning fundraising costs to programming expenses.[200]

Mandated disclosure gives legislators and regulators a pass in the sense that they can comfort themselves that mandated disclosure is an effective weapon against fraud and deceit. In Ben-Shahar and Schneider's well-crafted prose:

> Mandated disclosure is a Lorelei, luring lawmakers onto the rocks of regulatory failure. It is alluring because it resonates with two fundamental American ideologies. The first is free-market principles. Mandated disclosure may constrain unfettered rapacity and counteracts caveat emptor, but the intervention is soft and leaves everything substantive alone: prices, quality, [and] entry. Instead of specifying outcomes of transactions or dictating choices, it proffers information for making better decisions. Second, mandated disclosure . . . supposes that people make better decisions for themselves than anyone can make for them and that people are entitled to freedom in making decisions.
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> . . . .
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> Mandated disclosure appeals to lawmakers for other reasons. First, it looks cheap. It requires almost no government expenditures, and its costs seem to be imposed on the story's villain, the stronger party who withholds information.
>
> Second, mandated disclosure looks easy. It just requires more communication between parties who are already communicating; in hindsight, the information that could have led a trouble-story victim to a better decision seems obvious. . . .
>
> Third, mandated disclosure looks effective. Mandated information often seems relevant to a difficult decision. . . .
>
> For all these reasons, lawmakers rarely inquire into the effectiveness or burden of disclosure.[201]

However, mandated disclosure does not affect charities' behavior substantially because few donors seek the information.[202] As a result, it does little to improve donor knowledge or protection. Information can be difficult to find on the internet and not readily understandable. The Form 990 Annual Information Return is an example. The length of the form requires a level of knowledge that the average donor neither has nor desires to attain. For donors contributing small amounts, failure to acquire the knowledge needed to investigate the mandatorily disclosed information may be viewed as rational

198 *See id.*

199 *See* FISHMAN, SCHWARZ & MAYER, *supra* note 31, at 247; Espinoza, *supra* note 7, at 655.

200 *See* FISHMAN, SCHWARZ & MAYER, *supra* note 31, at 247, 291–92.

201 Ben-Shahar & Schneider, *supra* note 197, at 681–83.

202 *See id.* at 724.

apathy.[203] This means the cost of finding the information necessary to make the correct decision to donate is not worth the time expended, particularly when the main benefit small donors receive may be a sense of community or religiosity or the warm glow of doing a good deed.[204]

IV. A PRESUMPTION AGAINST PERMISSION TO SOLICIT WHERE AN ORGANIZATION'S CHARITABLE ACTIVITIES ARE NOT COMMENSURATE WITH ITS RESOURCES, ITS PUBLIC PURPOSE, OR THE CHARITABLE CLASS SERVED

A. *Charities Must Serve a Public Purpose and Assist a Broad Charitable Class*

Another route to state regulation of charitable solicitation is through the common law doctrine that a charity must serve a public purpose rather than the private benefit of individuals.[205] A basic assumption of charitable status in the common law of charitable trusts and the statutory law of federal income taxation is that exemption from taxation requires justification in social terms. That is, that society is benefitting from the philanthropic entity apart from the value to individual beneficiaries or the moral purpose of the organization.[206] Essentially, the idea is that the organization must serve a public purpose or benefit one of the broadly recognized charitable categories.[207]

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203 The concept of rational apathy is often used with retail investors. Assume an investor owns one hundred shares of stock of a company involved in a proxy fight. A rational shareholder will expend the effort to make an informed decision only if the expected benefits of doing so outweigh the costs. Given the length and complexity of proxy statements, where the shareholder is receiving multiple communications from the contending parties, the opportunity cost entailed in reading the proxy statements before voting is quite high, and the consequences of the investor's vote having an impact on the result is virtually nil. *See* Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 526–29 (1990); Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U. CAL. DAVIS L. REV. 605, 622 (2007).

204 In a sense, giving to charity may be like voting. In very few elections does an individual vote matter, and voting is in actuality a statement of responsible citizenship and public morality.

205 RESTATEMENT (THIRD) OF TRUSTS § 28 (AM. LAW. INST. 2003).

206 Chauncey Belknap, *The Federal Income Tax Exemption of Charitable Organizations: Its History and Underlying Policy*, in IV RESEARCH PAPERS 2025, 2027 (Comm'n on Private Philanthropy & Public Needs 1977); Miriam Galston, *Public Policy Constraints on Charitable Organizations*, 3 VA. TAX REV. 291, 303 (1984).

207 *See* RESTATEMENT (THIRD) OF TRUSTS § 28, cmt. a (AM. LAW. INST. 2003). "Charitable trust purposes include: (a) the relief of poverty; (b) the advancement of knowledge or education; (c) the advancement of religion; (d) the promotion of health; (e) governmental or municipal purposes; and (f) *other purposes that are beneficial to the community*." *Id.* § 28 (emphasis added). The expectation that charities must serve a public benefit and cannot violate public policy was expressed in *Bob Jones v. United States*: "[C]harities were to be given preferential treatment because they provide a benefit to society." 461 U.S. 574, 589 (1983).

Charity is an elastic and expansive concept, but activities so considered must benefit a charitable class.[208] In a classic opinion, the Massachusetts Supreme Court stated that a charitable gift is one that would "benefit . . . an indefinite number of persons."[209] A charitable trust may fail because the class that benefits is so narrow that the community has no interest in the performance of the trust. Whether the class is large enough to make the performance of the trust sufficient to benefit the community so that it will be upheld as a charitable trust is a question of degree.[210] Thus, a charitable trust must benefit a sufficiently large and indefinite charitable class, rather than specific private individuals.[211] A similar rule applies to charitable corporations.[212] Even if a trust is for a valid charitable purpose, the class of persons benefitted may be so narrow that the trust is not charitable.[213] "An undertaking conducted for private profit is not charitable . . . even if the purpose is such that, if it were not conducted for private profit, it would be charitable."[214]

B. *The Federal Income Tax Standard that a Charity Must Serve a Public Purpose Rather than Private Interests*

Under § 501(c)(3) of the Internal Revenue Code and the Treasury Regulations promulgated thereunder, "[a]n organization will be regarded as *operated exclusively* for one or more exempt purposes only if it engages primarily in activities which accomplish" one of the purposes listed in § 501(c)(3).[215] Those purposes include activities with religious, charitable, scientific, literary, or educational purposes. These organizations must ensure that no part of their net earnings from contributions "inures to the benefit of

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208 RESTATEMENT (THIRD) OF TRUSTS § 28, cmt. a (AM. LAW. INST. 2003).

209 Jackson v. Phillips, 96 Mass. 539, 556 (1867).

210 *See* RESTATEMENT (SECOND) OF TRUSTS § 375 (AM. LAW. INST. 1959); 6 AUSTIN WAKEMAN SCOTT, WILLIAM FRANKLIN FRATCHER & MARK L. ASCHER, SCOTT & ASCHER ON TRUSTS § 38.9 (5th ed. 2009). If the trust's purpose is to relieve poverty, promote knowledge or education, advance religion, or protect health, the class need not be as broad as it needs to be when the benefits to be conferred are unrelated to any of these [particularly purposes under Restatement § 28, clause (f))]. On the other hand, . . . the class of persons benefitted may be so narrow that the trust is not charitable, although the purpose of the trust is to relieve their poverty, to educate them, to save their souls, or to promote their health. *Id.* at § 38.9. And in § 375.2, it is observed that "[e]ven though the purposes of the trust are charitable in character, the trust is not a valid charitable trust if the benefits are limited to too small a class of persons." 4 AUSTIN WAKEMAN SCOTT, THE LAW OF TRUSTS § 375.2 (3d ed. 1967).

211 RESTATEMENT (THIRD) OF TRUSTS § 28, cmt. a.

212 "Despite their different legal forms, courts subjected charities that were corporations and those that were trusts to the same limitations on their purposes and operations, and each also benefited from the same privileges." RESTATEMENT OF THE LAW OF CHARITABLE NONPROFIT ORGS. § 1.01, cmt. a (AM. LAW. INST., Tentative Draft No. 1, 2016).

213 RESTATEMENT (SECOND) OF TRUSTS § 375 cmt. a.

214 SCOTT, FRATCHER & ASCHER, *supra* note 210, at § 38.10.

215 Treas. Reg. § 1.501(c)(3)-1(c)(1) (2017).

any private shareholder or individual."[216] The charitable organization must be operated primarily to advance the purposes for which the organization has obtained tax-exempt status and must serve a public rather than a private interest.[217]

To be exempt under § 501(c)(3), an organization must qualify under both an organizational and an operational test.[218] The organizational test relates to the language used in the organization's governing document, a trust instrument, articles of incorporation or association, or charter.[219] The language must "limit the purposes of the organization to one or more exempt purposes" in § 501(c)(3) and "not expressly empower the organization to engage (except to an insubstantial degree) in any activities which do not further one or more exempt purposes."[220] Upon dissolution, the organization's assets must be distributed to another § 501(c)(3) organization in furtherance of an exempt purpose.[221]

The operational test requires an organization's activities to be primarily those that accomplish one or more exempt purposes as specified in § 501(c)(3) and not, except to an insubstantial part, those that do not.[222] A substantial nonexempt purpose will disqualify an organization from tax exemption despite the number or importance of its exempt purposes.[223] The operational test focuses on the purpose and not on the nature of the activity.[224] An organization may engage in a trade or business as long as its operation furthers an exempt purpose and its primary objective is not the production of profits.[225] "An organization is not organized or operated exclusively for one or more [exempt purposes] . . . unless it serves a public rather than a private interest."[226] Whether an organization satisfies the operational test is a question of fact.[227]

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216 *Id.* § 170(c)(2)(C); *see also* Founding Church of Scientology v. United States, 412 F.2d 1197 (Cl. Ct. 1969) (holding a church that provided many benefits for the founder and his family was not exempt).

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> [A]n organization is not organized or operated exclusively for one or more of the [charitable purposes] . . . unless it serves a public rather than a private interest. . . . [I]t is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

218 *Id.* § 1.501(c)(3)-1(a)(1).

219 *Id.* § 1.501(c)(3)-1(b)(2).

220 FISHMAN, SCHWARZ & MAYER, *supra* note 31, at 291–92; *accord* Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)(B).

221 Treas. Reg. § 1.501(c)(3)-1(b)(4).

222 *Id.* § 1.501(c)(3)-1(c)(1).

223 *See* Better Business Bureau v. United States, 326 U.S. 279, 283 (1945).

224 Treas. Reg. § 1.501(c)(3)-1(c)(1).

225 *See Id.* § 1.501(c)(3)-1(c)(2).

226 *Id.* § 1.501(c)(3)-1(d)(1)(ii).

227 *See Id.* § 1.501(c)(3)-1(c)(3)(iv).

C. *The Commensurate Standard*

A basic question for determining exemption is whether a charity provides services to the public comparable to its favored tax status. In a 1964 revenue ruling, the IRS introduced the "commensurate" test, which merely holds that a charitable organization that raises funds for an exempt purpose must carry on a "charitable program commensurate in scope with its financial resources" and cannot confer an impermissible private benefit to individuals or entities associated with the charity.[228] The IRS has not been consistent in its application of the doctrine but fundamentally seems to use a facts-and-circumstances test.[229]

Although the 1964 revenue ruling did not refer to charitable solicitation, the IRS later attempted to apply the test to police what it perceived as abusive contingent-fee fundraising where an organization used most of its funds to pay professional fundraisers. It seems that the charitable program of an organization which over a long period of time raised most of its funds from professional solicitors, devoted the great majority of these funds to pay their contingent fees, and used a large percentage of the amounts remaining for administrative expenses as opposed to programmatic costs would not be commensurate with the funds contributed to the organization.

D. *Private Inurement and Private Benefit*

The IRS has several ways to deal with excessive payments to insiders of charities or others associated in some way with an organization such as their fundraisers—namely, the prohibitions against private inurement, I.R.C. § 4958, and the commensurate standard. To qualify for exempt status under § 501(c)(3), no part of an organization's net earnings may inure "to the benefit of any private shareholder or individual."[230] In other words, the organization cannot engage in transactions that primarily benefit insiders.[231] A related

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228 Rev. Rul. 64-182, 1964-1 C.B. 186. The two-paragraph revenue ruling was primarily about whether an organization could qualify for exemption despite substantial unrelated business if its primary purpose was charitable by giving grants to other charitable organizations. *Id.* The revenue ruling held that the organization could qualify because it was organized and operated for charitable purposes "where it [was] shown to be carrying on through such contributions and grants a charitable program commensurate in scope with its financial resources." *Id.*

229 *See* FISHMAN, SCHWARZ & MAYER, *supra* note 31, at 544–46. The Service's use of a facts and circumstances test as applied to excessive fundraising costs was criticized by Judge Posner in *United Cancer Council, Inc. v. Comm'r*. 165 F.3d 1173, 1179 (7th Cir. 1999) ("That is no standard at all, and makes the tax status of charitable organizations and their donors a matter of the whim of the IRS.").

230 26 U.S.C. § 501(c)(3) (2012); Treas. Reg. § 1.501(c)(3)-1(c)(2) (as amended in 2014).

231 *See* John D. Colombo, *In Search of Private Benefit*, 58 FLA. L. REV. 1063, 1067 (2006).

private benefit doctrine denies exemption when persons other than insiders receive more than an incidental "private benefit."[232]

Whereas the inurement prohibition is part of the statute, the private benefit limitation is a product of the Treasury Regulations.[233] It holds that an organization must serve a public purpose and cannot be operated for the private benefit or interests of certain individuals, such as a founder, shareholders, or entities controlled directly or indirectly by such private interests.[234] These private interests may not strictly be insiders but could extend to a charitable solicitation firm that controls a charity through its operation of a fundraising campaign or receives so much of the money donated that the charitable organization is not, for all practical purposes, operated exclusively for exempt purposes.

In *United Cancer Council v. Commissioner*,[235] the IRS sought to extend the private inurement and private benefit doctrines to deal with what it considered excessive contingent fee fundraising.[236] One can also view the IRS's theory in the case from a commensurate perspective: because of the fundraising firm's control over the charity's resources, the latter did not provide commensurate public services compared to its overall resources. Its tax exemption, therefore, should be revoked.

The United Cancer Council ("UCC")[237] entered an agreement with a fundraising firm, Watson & Hughey ("W & H").[238]

> Because of UCC's perilous financial condition, the committee wanted W & H to "front" all the expenses of the fundraising campaign, though it would be reimbursed by UCC as soon as the campaign generated sufficient donations to cover those expenses. W & H agreed. But it demanded in return that it be made UCC's exclusive fundraiser during the five-year term of the contract, that it be given co-ownership of the list of prospective donors generated by its fundraising efforts, and that UCC be forbidden, both during the term of the contract and after

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232 *Id.* at 1064.

233 *See id.* at 1067–68; 26 U.S.C. § 501(c)(3) (providing in part: "no part of the net earnings of which inures to the benefit of any private shareholder or individual").

234 FISHMAN, SCHWARZ & MAYER, *supra* note 31, at 429–30; *see also* Treas. Reg. § 1.501(c)(3)-1(d)(1)(iii) (2017) (providing examples).

235 165 F.3d 1173 (7th Cir. 1999).

236 *Id.* at 1174–75.

237 UCC was a charity that sought, "through affiliated local cancer societies, to encourage preventive and ameliorative approaches to cancer, as distinct from searching for a cure, which ha[d] been the emphasis of the older and better-known American Cancer Society." *Id.* at 1174.

238 *Id.* at 1175. W & H had a long history of conflict with state regulators. *See* Commonwealth v. Watson & Hughey Co., 563 A.2d 1276 (Pa. Commw. Ct. 1989). Over a two-year period from 1989 to 1991, W & H was found guilty of violations of charitable solicitation laws in fourteen states and paid fines and restitution of $2.1 million. *See* Tampa Bay Times & Ctr. for Investigative Reporting, *Disciplinary Actions: Watson & Hughey Co./Direct Response Consulting Services* (2013), http://charitysearch.apps.cironline.org/detail/watson-hughey-12448. Despite this history, W & H remains in business under a different name, Direct Response Consulting Services. DIRECT RESPONSE CONSULTING SERVICES, www.drcs.com (last visited Sept. 9, 2017).

> it expired, to sell or lease the list, although it would be free to use it to solicit repeat donations. There was no restriction on W & H's use of the list.[239]

During the five-year term of the contract, W & H raised $28.8 million of which $26.5 million went to W & H for expenses.[240] UCC received $2.3 million, which was spent on services to cancer patients and research.[241] The IRS revoked UCC's charitable exemption, alleging it was operated not exclusively for charitable purposes, but also for the private benefit of the fundraising company.[242] The IRS also claimed that part of the charity's net earnings inured to the benefit of a private shareholder or individual—W & H. UCC appealed to the Tax Court, which upheld the revocation on the ground of private inurement but did not reach the private benefit issue.[243] An appeal to the U.S. Court of Appeals for the Seventh Circuit followed.

The Seventh Circuit, in a decision by Judge Richard Posner, found no private inurement.[244] The IRS had not contended "that any part of UCC's earnings found its way into the pockets of any members of the charity's board" or "that any members of the board were owners, managers, or employees of W & H, or relatives or even friends of any of W & H's owners, managers, or employees."[245] "It concede[d] that the contract between charity and fundraiser was negotiated at an arm's length basis."[246] The IRS argued that "the contract was so advantageous to W & H and so disadvantageous to UCC that the charity must be deemed to have surrendered the control of its operations and earnings" to its professional solicitor.[247]

As far as the high fundraising costs, the Seventh Circuit found that "UCC got a charitable 'bang' from the mailings," which contained some educational materials in support of its educational goals.[248] Importantly, it said that the cost of fundraising—that is, "the ratio of expenses to net charitable receipts"—was "unrelated to the issue of inurement."[249] W & H's favorable

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239 *United Cancer Council*, 165 F.3d at 1175. "W & H mailed 80 million letters soliciting contributions to UCC. Each letter contained advice about preventing cancer, as well as a pitch for donations; 70 percent of the letters also offered the recipient a chance to win a sweepstake." *Id.*

240 *Id.*

241 *Id.* UCC did not renew the contract when it expired by its terms in 1989. Instead, it hired another fundraising organization—with disastrous results. The following year, UCC declared bankruptcy, and within months the IRS revoked its tax exemption retroactively to the date on which UCC had signed the contract with W & H. The effect was to make the IRS a major creditor of UCC in the bankruptcy proceeding. *Id.* at 1175–76.

242 *Id.* at 1174–75.

243 United Cancer Council, Inc. v. Comm'r, 109 T.C. 326, 397, 399 (1997).

244 *United Cancer Council*, 165 F.3d at 1178–79.

245 *Id.* at 1175.

246 *Id.* "A committee of the board picked W&H," and "[a]nother committee of the board was created to negotiate the contract" between the charity and the professional solicitor. *Id.*

247 *Id.*

248 *Id.* at 1178.

249 *United Cancer Council*, 165 F.3d at 1178.

contract was due to the desperation of UCC rather than disloyalty of the board.[250] Nor was there any diversion of assets to insiders.[251]

Judge Posner then suggested that the private benefit doctrine, in certain situations, could be used to deal with particularly harsh agreements.[252] Under that theory, UCC would be considered to operate for the private benefit of the fundraiser. The Court remanded the private benefit issue to the Tax Court.[253]

United Cancer Council was a case of statutory construction, but it also could be viewed as a question of constitutional law. UCC might have argued that the statutory private inurement prohibition and the Treasury Regulation containing the private benefit doctrine impermissibly impinged on the protected speech of their solicitation campaign. The fundamental issue in response to that argument would be whether the resources spent for UCC's charitable programs after payment of fundraising fees were commensurate with the total resources raised.

E. *The Prohibition Against Excess Benefit Transactions I.R.C. § 4958*

The unsuccessful effort in the *United Cancer Council* case to link excess fundraising costs to private inurement aside, the IRS has rarely used the revocation of exemption penalties for violations of the private inurement or private benefit proscriptions. The doctrine's ineffectiveness in curbing abuses, the disproportionate nature of the penalty, and the fact that it targeted the organizations, rather than the individual wrongdoers, made it unsuitable in many cases.

As a result, Congress enacted I.R.C. § 4958, the so-called intermediate sanctions legislation, which imposes an excise tax on individuals, termed "disqualified persons," who engage in excess benefit transactions, either of the inurement or private benefit variety. There is a possible tax on the charity's executives as well.[254] Theoretically, § 4958 could be used against a

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250 *Id.*

251 *Id.* at 1179.

252 *See id.* at 1180.

253 *Id.* On remand, the private benefit issue was never reached because the case was settled. Lisa A. Runquist, *How to Keep Your Nonprofit out of Trouble with the IRS,* LISA A. RUNQUIST: ATTORNEY AT LAW (Jan. 2001), http://runquist.com/how-to-keep-your-nonprofit-out-of-trouble-with-the-irs. UCC, which had filed for bankruptcy, conceded it was not entitled to exemption for the years 1986–89, and the IRS restored UCC's exemption for 1990 forward. *Id.* As a condition of the settlement, UCC agreed to cease raising funds from the general public and to limit its activities to accepting charitable bequests and transmitting them to local cancer counsels for direct care of patients. *Id.*

254 26 U.S.C. § 4958(a)(2) (2012). In egregious situations, the IRS can still revoke an exemption after considering all relevant facts and circumstances, considering several factors including the size and scope of the organization's regular and ongoing activities that further exempt purposes before and after excess benefit transactions occurred. Treas. Reg. § 1.501(c)(3)-1(f)(2)(ii) (2017).

fundraiser guilty of excessive financial benefits, where the solicitor controlled the charity or the contract between them was egregious. There has been minimal enforcement under § 4958, though charities have used the complicated procedures in the regulations to sanitize compensation and other transactions to avoid the "excessive benefit" designation. Using the legislation to police excessive fundraising expenses is also hindered by what is called a "first bite" or initial contract exception.[255]

F. *The Initial Contract Exception*

An exception to the tax regime of I.R.C. § 4958 is an initial written agreement with fixed payments between an organization and an individual who will become a disqualified person upon signing the contract.[256] Thus, a fundraiser, who will become a disqualified person after entering into an agreement with a charity, is not subject to a potential intermediate sanction for the initial contract. Surprisingly, neither the statute, the legislative history, nor the proposed regulations associated with § 4958 contained an initial contract exception.[257] It came from Judge Posner's holding in *United Cancer Council* that private inurement could not result from a contractual relationship negotiated at arms-length with a party having no prior relationship with the exempt organization, regardless of the relative bargaining strengths of the parties.[258] There may be, however, a further exception to the initial contract exemption, which allows such contracts to come under § 4958.[259]

Ideally, the IRS would enforce excessive, deceitful or fraudulent charitable solicitation, but at present that is wishful thinking. Because of budget cuts, the political hostility of Congress, and a seeming lack of willpower, the

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255 *See* Nicholas A. Mirkay, *Relinquish Control! Why the IRS Should Change Its Stance on Exempt Organizations in Ancillary Joint Ventures*, 6 NEV. L.J. 21, 80 (2005); Treas. Reg. § 53.4958-4(a)(3).

256 Treas. Reg. § 53.4958-4(a)(3). Initial contract or agreement "means a binding written contract between an applicable tax-exempt organization and a person who was not a disqualified person within the meaning of section 4958(f)(1) and [Treas. Reg. §] 53.4958-3 prior to entering the contract." *Id.*

257 STAFF OF J. COMM. ON TAX'N, 109TH CONG., REP. ON OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES 268 (Comm. Print 2005).

258 *See id.*

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> A fixed payment does not include any amount paid to a person under a reimbursement or similar arrangement where any person with respect to the amount of expenses incurred or reimbursed exercises discretion. The standard fundraising agreement contains a percentage of receipts from the campaign that belong to the solicitor. Nevertheless, the solicitor also has the right of reimbursement of expenses and manages the campaign. It can control the amount of expenses incurred, the primary reason that many fundraising campaigns wind up with the charity not only failing to obtain additional resources, but still owing the solicitor for expenses beyond the amount raised. In the course of running the campaign, the solicitor controls the expenses. This would seem to be a non-fixed liability and one could argue not subject to the initial contract exception.

Fishman, *supra* note 29, at 32; *see also* Treas. Reg. § 53.4959-4(a)(3)(ii)(a).

IRS has retreated from its oversight responsibilities.[260] This means that the states or some other federal agency such as the FTC should step in to apply the legal doctrines discussed above. A problem is that few states have proactive and vigorous enforcement against charity fraud, but through the use of common law doctrines such as the requirement of commensurate charitable purpose, combined with a lesser standard of judicial scrutiny of impingement on speech, misleading charitable solicitation can be curtailed.

G. *Reconfiguring the Facts of* Riley

It is clear from the Supreme Court trilogy that a statute mandating a solicitor to disclose the amount of funds raised that will be turned over to the charity is content-based speech and will not pass constitutional muster. Nor is it likely that an official's discretionary power to deny or delay a permit when protected speech is involved will be upheld. The North Carolina statute in *Riley* was also flawed because it did not create a sufficient nexus between the state's interest and the statutory regulation of permissible fees.[261]

Let us reconfigure the facts of *Riley* such that the cost of fundraising is not directly regulated, nor is the impact on the charity's speech. The official or state disapproval reflects an organization's lack of charitable activity over a period of time given its resources, and this creates a rebuttable presumption that the charity is not serving a charitable purpose that is commensurate with its means. Assume that a charity, over a period of eight years or more, spends at least 85 percent of funds raised in the name of the charity to pay its solicitation firm, and after allocation of general overhead expenses, the charity spends an average of less than 15 percent of its budget on activities toward the attainment of its mission.[262] Further assume a state enacts legislation that

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260 There have been calls by serious scholars to remove the IRS from the oversight of charities. *See* Evelyn Brody & Marcus Owens, *Exile to Main Street: The I.R.S.'s Diminished Role in Overseeing Tax-Exempt Organizations*, 91 CHI.-KENT L. REV. 859, 893 (2016); Lloyd Hitoshi Mayer, *"The Better Part of Valour Is Discretion": Should the IRS Change or Surrender Its Oversight of Tax Exempt Organizations?*, 7 COLUM. J. TAX L. 80 (2016).

261 *See* Riley v. Nat'l Fed'n of the Blind of N.C., Inc., 487 U.S. 781, 793 & n.7 (1988).

262 Long after this hypothetical was conceived, a real-world example offered a similar fact pattern. The Illinois Attorney General forced a telemarketer, Safety Publications, to cease operations in the state because the firm misled donors to raise millions for veterans and did not properly report the funds it raised for charity. David Jackson, *Chicago Telemarketer Is Shut Down After Tribune Investigation of Charity Law Violations*, CHI. TRIB. (June 1, 2017), http://www.chicagotribune.com/news/watchdog/ct-telemarketer-charity-met-20170531-story.html. One of the cofounders, who had failed to disclose his felony arson conviction when registering as a fundraiser, was barred for life. *Id.* The other cofounder agreed to a three-year ban. *Id.*

Safety Publications reported raising $4.9 million for VietNow, the primary charity, and some other organizations from 2008 through 2014 but "gave the nonprofits only about 15 cents of every dollar raised in those seven years and kept the rest for itself . . . Many of those charities in turn spent large sums on administrative overhead, leaving pennies for those in need." *Id.* Safety Publications "did not properly

charities that have similar allocations of expenditures over time create a presumption that the organization is serving the interests of either its insiders, directors, officers, and key employees or benefitting external contractors, such as a professional solicitation firm, so its delivery of charitable services is not commensurate with the common law and federal or state tax requirements that charities must serve a public purpose.

What this hypothetical suggests is that tax exemption of charities be judged under a standard that would condition continued exemption on whether the charity, given its resources and programs, provides a public service commensurate with its size. If not, the charity could lose its exemption from state or federal taxation. The organization's donors would not receive the normal charitable deduction as provided by law.

In *Bob Jones v. United States*,[263] the Court quoted the legislative history of the charitable exemption statute of 1917 where Senator Hollis articulated its rationale: "For every dollar that a man contributes for these public charities, educational, scientific, or otherwise, the public gets 100 per cent."[264] In the presumption used in the hypothetical, the reverse is true. For all money contributed, the public gets a paltry percentage that benefits society or the charity's beneficiaries. Unlike the cost of fundraising legislation in the Supreme Court trilogy, denial of exemption does not directly restrict charities' protected speech. Any impact on speech is indirect and tenuous. It removes a tax benefit to a third party. There is no constitutional right to preferential tax treatment. Would such legislation pass constitutional muster, and under

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report the funds it raised for the charity VietNow National Headquarters of Rockford, among other breaches of state charity laws." *Id.* It violated Illinois law against using felons for charity fundraising by employing, since 2007, at least ten callers, "who served prison terms for bank robbery, forgery, child rape and other felonies." *Id.* This was the attorney general's third enforcement action against the fundraiser. Jackson, *supra*.

VietNow was one of the respondents in the Supreme Court case of *Illinois ex rel. Madigan v. Telemarketing*, where the fundraisers made knowingly deceptive and materially false statements to potential donors that each dollar donated would be used for charitable endeavors, when in fact 85 percent went to the fundraisers. 538 U.S. 600, 605 (2003). The Supreme Court unanimously held that fraudulent charitable solicitation was unprotected by the First Amendment. *Id.* at 624. Other actions have been brought against VietNow in Michigan and Missouri. Jackson, *supra*.

In November 2017, officials from two dozen states acting jointly forced the dissolution of Vietnow for deceptive telemarketing solicitations. The organization agreed to the appointment of a receiver in a settlement, which contained injunctive relief against the organization's directors and officers and required their cooperation in investigation of the organization's professional fundraisers. Upon dissolution, remaining funds would be distributed to legitimate veterans' organizations. *See* David Jackson & Gary Marx, *Vietnam Veterans Charity Dissolved After Egregious Fraud*, CHI. TRIB. (Nov. 6, 2017), http://www.chicagotribune.com/news/watchdog/ct-vietnow-met-20171106-story.html. The settlement agreement is available at https://ag.ny.gov/sites/default/files/vietnow.settlement.agreement.final_.signed.11.6.17.pdf.

263 461 U.S. 574 (1983).

264 *Id.* at 590 (quoting 55 CONG. REC. 6728 (1917)).

what standard would a court review it? Oregon has enacted a statute that fits the hypothetical.

H. *The Oregon Approach to Excessive Fundraising Costs*

Oregon has introduced a novel approach to states' repeated efforts to control the high administrative and fundraising costs of charities.[265] It enacted legislation that allows the attorney general to disqualify charities from receiving tax-deductible contributions for Oregon state income tax purposes.[266] If an Oregon charity fails "to expend at least 30 percent of the organization's total annual functional expenses on program services" as that phrase is used on IRS Form 990 when those expenses are averaged over the most recent three fiscal years, it will lose its state tax exemption, though remain federally exempt from taxation under I.R.C. § 501(c)(3).[267]

The statute is a variant application of a commensurate test to contingent fee fundraising. Unlike *Riley* and the other Supreme Court CFR cases, there is no attempt to prohibit a charity that fails the standard from soliciting for contributions.[268] The Oregon statute implies that the state will not subsidize donors through the charitable deduction or the organization's continued exemption from taxation until its charitable activities are commensurate with the resources it receives.

Exempted from the legislation are private foundations, community trusts or foundations, qualified charitable remainder trusts, charities that do not have to file Form 990, and charities that have operated for less than four years.[269] The attorney general can exempt organizations that accumulated money for a specific purpose such as a capital campaign or that present "other mitigating circumstances."[270] Affected charities must disclose to their donors that they cannot deduct their contributions for state tax purposes or face fines up to $25,000.[271]

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265 *See* Suzanne Stevens, *Taking On Oregon's Rogue Charities*, PORTLAND BUS. J. (June 12, 2013, 7:16 AM), http://www.bizjournals.com/portland/morning_call/2013/06/new-oregon-law-targets-rogue charities.html.org/2013/06/17/oregon-sets-30-program-spending-benchmark-for-charities/.

266 *See* OR. REV. STAT. §§ 128.760–69 (2015).

267 *Id.* § 128.760(1).

268 *See Id.* §§ 128.760–69.

269 *Id.* § 128.760(4).

270 *Id.* § 128.760(2).

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> In any suit brought under ORS 646.632 [Enjoining unlawful trade practices), if the court finds that a person is willfully using or has willfully used a method, act or practice declared unlawful by ORS 646.607 [Unlawful business, trade practices] or 646.608 [Additional unlawful business, trade practices], the prosecuting attorney, upon petition to the court, may recover, on behalf of the state, a civil penalty to be set by the court of not exceeding $25,000 per violation.

Id. § 646.642(3).

Unlike the Supreme Court cases that struck down attempts to limit the cost of fundraising through statutory limits, this legislation regulates the ability of charities to use the state subsidy provided by tax exemption. There is no licensing requirement or other restriction on soliciting.[272] If the attorney general disqualifies a charity, it may continue to solicit funds but must disclose to potential donors that there is no charitable deduction for their Oregon taxes, though the federal deduction under I.R.C. § 170 would remain. Apparently, many Oregon charities would fail to keep their state tax exemptions.[273]

Oregon's approach is arguably similar to the challenge to § 501(c)(3) that was upheld in *Regan v. Taxation with Representation*.[274] There, an organization, Taxation with Representation ("TWR"), was denied exemption under § 501(c)(3) because it appeared that a substantial part of its activities consisted of attempting to influence legislation, which is not permitted by § 501(c)(3).[275] TWR "claimed the prohibition against substantial lobbying [was] unconstitutional under the First Amendment and the equal protection component of the Fifth Amendment's Due Process Clause."[276] The alleged equal protection violation was that taxpayers could deduct a certain percentage of contributions to veterans' organizations, some of which had unlimited lobbying privileges in furtherance of their exempt purposes.[277]

The Supreme Court, in a decision by Chief Justice Rehnquist, held that that § 501(c)(3) did not violate the First Amendment or the equal protection clause of the Fifth Amendment, since it was rational "for Congress to decide that, even though it [would] not subsidize substantial lobbying by charities generally, it [would] subsidize lobbying by veterans' organizations."[278] The Court concluded that Congress, in granting tax exemption to certain nonprofit organizations that did not engage in substantial lobbying activities, simply chose not to pay for a nonprofit corporation's lobbying and did not regulate any First Amendment activity.[279] Additionally, "[l]egislatures have

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272 *See* OR. REV. STAT. §§ 128.760–69.

273 Using the Guidestar database, the Chronicle of Philanthropy scanned the Form 990s of more than 100,000 nonprofits and found that more than one-fifth would not have met the guidelines of the Oregon bill. Lisa Chiu, *Many Charities Don't Tell IRS How Much They Spend on Programs*, CHRON. PHILANTHROPY (May 1, 2011), http://philanthropy.com/article/Many-Charities-Don-t-Tell/127302/. Of those charities, almost 96 percent would have failed to meet Oregon's requirement because they left blank or filled in zero on the line where they were to report program spending. *Id.*

274 461 U.S. 540 (1983).

275 TWR could create a § 501(c)(4) organization to pursue its lobbying goals, though such organizations are not eligible to receive tax-deductible contributions. *Id.* at 543 (citing 26 U.S.C. § 501(c)(4) (2012)).

276 *Id.* at 542.

277 *Id.* at 546–47.

278 *Id.* at 550.

279 *Id.* at 546.

especially broad latitude in creating classifications and distinctions in tax statutes."[280]

Although § 501(c)(3) might have impinged on speech, it was not "intended to suppress any ideas," nor was there any "demonstration that it had that effect," so the statutory provision did not contain any suspect classification that warranted a higher level of scrutiny to determine whether the prohibition against substantial lobbying was invalid under the equal protection component of the Fifth Amendment.[281] The standard applied by the Court was whether the statute had "a rational relation to a legitimate governmental purpose."[282] Significantly, the Court also stated that the "legislature's decision not to subsidize the exercise of a fundamental right [did] not infringe on that right and . . . [was] not subject to strict scrutiny."[283]

The Car Donation Foundation, a charity that averaged spending only 20.7 percent on its program services over three of its most recent fiscal years, challenged the Oregon statute and claimed the statute violated Article I of the Oregon Constitution and the First Amendment of the U.S. Constitution and operated to chill its solicitation speech.[284] Rejecting a motion to dismiss, an administrative law judge ("ALJ") upheld the statute, concluding it did not restrict the organization's rights to engage in protected charitable speech but affected the result of its solicitation efforts as it related to the donor's ability to deduct contributions for purposes of Oregon's income tax.[285] The requirement to disclose the lack of state charitable exemption was necessary to prevent misleading potential donors.[286] As in *Regan*, the ALJ held that Oregon could determine which organizations it wished to subsidize through state tax exemption.[287] An appeal of the order to the Oregon Court of Appeals is

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280 *Taxation with Representation*, 461 U.S. at 547.

281 *Id.* at 548.

282 *Id.* at 547.

283 *Id.* at 549.

284 Car Donation Found., Ruling on Mot. to Dismiss Notice, OAH Case No. 1604486 (Dep't of Justice, June 10, 2016) at 4 [hereinafter Ruling on Mot. to Dismiss Notice].

285 *Id.* at 3. The Oregon statute has been the subject of several administrative hearings: (1) a ruling on a motion to dismiss and notice of intent to issue disqualification, which focused primarily on the constitutionality of the Oregon statute under the First Amendment of the U.S. Constitution, and a notice of opportunity for a hearing (Ruling on Motion to Dismiss Notice) and (2) Proposed Order, which examined whether the statute violated the Commerce Clause under Article I, § 8, clause 3 of the U.S. Constitution or Article I, § 8 of the Oregon Constitution. *Id.*; *see also* Car Donation Found., Proposed Order, OAH Case No. 2017-ABC-00197 (Dep't of Justice, Apr. 3, 2017) [hereinafter Proposed Order]. Both hearings upheld the Oregon statute, denied the motion to dismiss, and required the Car Donation Foundation to disclose to Oregon donors that contributions to it are not deductible for Oregon income tax purposes. *See* Ruling on Mot. to Dismiss Notice, *supra* note 284, at 3; Proposed Order, *supra* at 5. Respondent Car Donation Foundation then proceeded to a contested hearing on its motion to dismiss, which it lost.

286 Ruling on Mot. to Dismiss Notice, *supra* note 284, at 11.

287 *Id.* at 9.

pending.[288] Presumably, if the Oregon statute comes under the holding of *Regan* and an intermediate scrutiny standard is applied, it will pass constitutional muster.

V. APPLICATION OF AN INTERMEDIATE STANDARD OF REVIEW FOR JUDICIAL EVALUATION OF CHARITABLE SOLICITATION REGULATION

The various attempts to regulate excessive charitable solicitation costs have foundered on the protections afforded speech that contains any educational element.[289] The Supreme Court has applied a standard of strict scrutiny when reviewing such legislation that directly impinges on constitutionally protected speech.[290] This section proposes that content-neutral charitable solicitation regulation should be evaluated under an intermediate standard of review when the scrutinized organization conducts fundraising campaigns over several years that offer minimal educational content in their solicitations, incur high costs, and deliver an insubstantial amount of services in the attainment of the organization's charitable mission.

The level of scrutiny applied to a statute ultimately is an issue of judicial discretion.[291] When a legislature enacts a law, it gives the officials and judges who interpret it directives or legal principles as to how they are to exercise their discretion.[292] These directives or principles are commonly classified as rules or standards.[293]

A. *Rules*

Rules are restrictive for decisionmakers because they confine them to facts, leaving arbitrary and subjective choices to be worked out elsewhere.[294] "Rules bring stability and certainty."[295] Individuals to whom rules apply should know the negative consequences of their actions and be able to plan

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288 Car Donation Foundation, Final Order, OAH Case No. 2017-ABC-00197 (Dep't of Justice Apr. 28, 2017).

289 *See* Riley v. Nat'l Fed'n of the Blind of N.C., Inc., 487 U.S. 781, 788 (1988).

290 *See, e.g.*, *id.* at 789–90.

291 *See* G. Edward White, *Historicizing Judicial Scrutiny*, 57 S.C. L. REV. 1, 2 (2005).

292 Kathleen M. Sullivan, *Foreword*: *The Justices of Rules and Standards*, 106 HARV. L. REV. 22, 58–59 (1991) [hereinafter *Foreword*]. The template discussed herein is based on the framework of Kathleen Sullivan in several articles, particularly *Foreword* and *Post-Liberal Judging: The Roles of Categorization and Balancing*, 63 U. COLO. L. REV. 293 (1992) [hereinafter *Post-Liberal Judging*].

293 *Foreword*, *supra* note 292, at 57.

294 *Id.* at 58.

295 Philip T. Hackney, *Charitable Organization Oversight: Rules and Standards*, 13 PITT. TAX REV. 83, 104 (2015).

to avoid them. They promote equal treatment, predictability, and minimal information costs in decisionmaking.[296]

A legal directive that is a rule captures a background principle or policy in a form that operates independently and may be over- or underinclusive in its application.[297] Decisionmakers follow rules "even when direct application of the background principle or policy to the facts would produce a different result."[298] Rules eliminate subjective actions against unpopular individuals, organizations, or causes by officials, such as the arbitrary refusal to grant a solicitation permit at issue in many of the earlier cases involving door-to-door fundraising.[299] For judges, rules provide for restraint and the separation of the law from the malleable use of facts.[300] However, rules can mask bias. They may not fit every situation and may lead to unfairness or injustice in a particular case. Strict scrutiny is a rule.[301]

B. *Standards*

"A legal directive is 'standard'-like when it tends to collapse decisionmaking back into the direct application of the background principle or policy to a fact situation," whereas a rule offers less discretion than a standard.[302] "Standards allow for the decrease of errors of under- and over-inclusiveness by giving the decisionmaker more discretion than do rules," enabling the decisionmaker to examine the totality of the circumstances and apply them to the case at hand.[303] This allows a decisionmaker to consider the different facts of cases and arrive at different decisions although the same standard applies.[304] Thus, standards provide more flexibility and may be more likely to achieve justice in a particular case by promoting fairness in similar factual situations and being less arbitrary.[305] Standards force judges to be more accountable to the facts of a particular case.[306]

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296 Factors that justify rules include promotion of fairness in that decisionmakers act consistently and provide certainty. *Id.* at 106. Rules are efficient for the decisionmaker compared to fact-based standards because there are minimal informational costs to reaching a decision and predictability of outcomes. Cass R. Sunstein, *Problems with Rules*, 83 CAL. L. REV. 953, 972–73 (1995). Rules bind the governmental decision so that individuals can plan. *Id.* at 971, 976. They also limit the scope of decisionmakers' jurisdiction, which provides equality of treatment. *Id.* at 975, 977–78.

297 *E.g.*, *Foreword*, *supra* note 292, at 89.

298 *Id.* at 58.

299 *See* Hackney, *supra* note 295, at 103.

300 *Cf. id.* at 105, 107.

301 *See Foreword*, *supra* note 292, at 85.

302 *Id.* at 58–59.

303 *Id.* (footnote omitted).

304 *Id.*

305 *Id.* at 66.

306 *Id.* at 67.

Another way to frame these concepts is the distinction commonly found in constitutional law between *categorization* and *balancing*. "Categorization corresponds to rules, balancing to standards. Categorization is taxonomic. Balancing weighs competing rights or interests. . . . [Categorization] defines bright-line boundaries and then classifies fact situations as falling on one side or the other."[307] For example, if strict scrutiny of a statute is applied, the government likely loses. If rational scrutiny applies—say, with an economic regulation—the government usually wins.

C. *Levels of Scrutiny*

A court will apply strict scrutiny analysis to a legislative classification only when that classification impermissibly interferes with the exercise of a fundamental right (such as speech) or operates to the peculiar disadvantage of a suspect class (such as race).[308] Thus, in *Riley*, the content-based regulation of the legislation is subject to exacting First Amendment scrutiny.[309] In practice, strict scrutiny analysis creates a substantial—usually insurmountable—burden on the government to justify the regulation. The noted constitutional scholar Gerald Gunther quipped that strict scrutiny is '"strict' in theory and fatal in fact."[310] In other words, the government almost always loses if a court applies a strict scrutiny standard of review.

Under a rational review standard, the challenged law must be rationally related to a legitimate government interest.[311] This is the most lenient standard.[312] In the absence of attempts to restrict liberties or rights of a fundamental constitutional basis, legislation need only rationally relate to the government's purpose.[313] Thus, rational scrutiny is deferential to typical socioeconomic legislation. Recall that in *Riley*, the state and the dissent categorized the statute as economic legislation, but the majority applied the strict scrutiny standard.[314]

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307 *Foreword*, *supra* note 292, at 59.

308 Mass. Bd. of Ret. v Murgia, 427 U.S. 307, 312 (1976); San Antonio Sch. Dist. v. Rodriguez, 411 U.S. 1, 16 (1973); Hughes v. City of Cedar Rapids, 840 F.3d 987 (8th Cir. 2016); *see also,* Richard H. Fallon, Jr., *Strict Judicial Scrutiny,* 54 UCLA L. Rev. 1267, 1268–69 (2007).

309 487 U.S. at 798.

310 Gerald Gunther, *Foreword: In Search of Evolving Doctrine on a Changing Court: A Model for a Newer Equal Protection*, 86 HARV. L. REV. 1, 8 (1972).

311 Thomas B. Nachbar, *The Rationality of Rational Basis Review*, 102 VA. L. REV. 1627, 1629 (2016).

312 *Id.*

313 *See Foreword*, *supra* note 292, at 60; RONALD ROTUNDA & JOHN NOWAK, TREATISE ON CONSTITUTIONAL LAW-SUBSTANCE & PROCEDURE §§ 15.4(e), 18.3(a)(ii) (1971).

314 *See* Riley v. Nat'l Fed'n of the Blind of N.C., Inc., 487 U.S. 781, 790 (1988); *id.* at 807–11 (Rehnquist, C.J., dissenting).

Intermediate scrutiny, the third approach between strict and rational review, is used in some contexts to determine a law's constitutionality.[315] To pass the intermediate scrutiny standard, the challenged law must further an important governmental interest by means that are substantially related to that interest.[316] Intermediate scrutiny is less rigorous than strict scrutiny and involves a balancing based on the facts before the court.[317] Both strict and rational reviews involve categorization, whereas intermediate scrutiny involves balancing.[318]

Balancing gives judges more discretion.[319] It occurs where the judge "[places] competing rights and interests on a scale and weigh[s] them against each other."[320] The judge may apply a multitude of factors to reach a result.[321] A criticism of balancing is that judges become legislators because of their exercise of the use of discretion in deciding cases.[322] There are valid arguments for categorization and for balancing.[323]

D. *Effects of the Strict Scrutiny Standard on Regulation of Charitable Solicitation*

A problem with the strict scrutiny standard of review for charitable solicitation regulation is that the spirit and sometimes the substance of the rule can be evaded.[324] Thus, a strict scrutiny rule which assumes that the educational component of the solicitation is always intertwined with the noneducational parts of the message, the mere pitch for funds, may not be empirically correct. It ignores the fact that the educational component may be an insignificant part of the message and even irrelevant to the solicitation component. This can allow unprincipled fundraisers and charities to elude the strictures against deceptive fundraising.

Regulation of charitable solicitation that impinges on speech is almost always reviewed under the strict scrutiny standard.[325] This allows the unscrupulous fundraiser or sham charity to evade meaningful review of its activities. Strict scrutiny discourages regulators from overseeing questionable and inefficient organizations.[326] Since it is almost impossible for a speech

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315 Jay Wexler, *Defending the Middle Way: Intermediate Scrutiny as Judicial Minimalism*, 66 GEO. WASH. L. REV. 298, 315 (1998).

316 *Id.* at 317–18.

317 *Id.* at 300–01.

318 *See id.* at 299–301.

319 *See Foreword*, *supra* note 292, at 58–59.

320 *Post-Liberal Judging*, *supra* note 292, at 293–94.

321 *Id.* at 294.

322 *Foreword*, *supra* note 292, at 97–98.

323 *See id.* at 66–69; Sunstein, *supra* note 296, at 972–77.

324 Sunstein, *supra* note 296, at 995.

325 *See* Riley v. Nat'l Fed'n of the Blind of N.C., Inc., 487 U.S. 781, 791 (1988).

326 *See* Fallon, *supra* note 308, at 1271–72.

regulation to overcome the strict scrutiny standard absent outright fraud, which is difficult to prove and a substantial consumer of scarce resources, rational regulators may be dissuaded from pursuing cases with a Sisyphean chance of success.

E. *Applying the Intermediate Scrutiny Standard to Charitable Solicitation Regulation*

Intermediate scrutiny would enable attorneys general to more easily challenge the activities of charities that exist for the organization's fundraisers or insiders. High fundraising costs over a period of time may indicate that the organization is not serving a charitable purpose but is benefiting insiders (private inurement), serving a private benefit to others, or assisting no recognized charitable class.

It is extremely difficult for a content- or viewpoint-based law to pass judicial scrutiny. If a statute is "neither content nor viewpoint based," it "need not be analyzed under the strict scrutiny standard."[327] When a court applies an intermediate scrutiny lens, governments are afforded "wider leeway to regulate features of speech unrelated to its content."[328] However, it is not so easy to get a court to apply an intermediate review standard.[329]

In *Billups v. City of Charleston*,[330] which has facts reminiscent of charitable solicitation cases concerning a government official's power to grant a permit to solicitors, tour-guide license applicants in Charleston, South Carolina alleged that the city's tour-guide regulations impermissibly burdened speech, so the applicants moved for a preliminary injunction to stop the city from enforcing such regulations.[331] The city moved to dismiss.[332] The court found that intermediate scrutiny was the appropriate level of review and denied the application for an injunction.[333] In the opinion, the court discussed the requirements of a law to meet the requirements of applying intermediate scrutiny: "[It] must be 'narrowly tailored to serve a significant governmental interest.' This inquiry recognizes that the First Amendment 'does not simply guard against an impermissible desire to censor,' and that a government may attempt to impermissibly restrict speech purely as a matter of

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327 McCullen v. Coakley, 134 S. Ct. 2518, 2534 (2014).

328 *Id.* at 2530; *see also* Wilson R. Huhn, *Assessing the Constitutionality of Laws that Are Both Content-Based and Content-Neutral: The Emerging Constitutional Calculus*, 79 IND. L.J. 801, 805–06 (2004).

329 *See* Wexler, *supra* note 315, at 315–20.

330 194 F. Supp. 3d 452 (D.S.C. 2016).

331 *Id.* at 458–59.

332 *Id.*

333 *Id.* at 467. The tour guide applicants were more fortunate after a bench trial. The court ruled that the licensing law was unconstitutional under the First Amendment. Billups v. City of Charleston, 331 F. Supp. 3d 500 (D.S.C. 2018).

convenience.'"[334] While governments are afforded "wider leeway to regulate features of speech unrelated to its content,"[335] or viewpoint, even if it is content neutral, "by demanding a close fit between ends and means, the tailoring requirement prevents the government from too readily 'sacrific[ing] speech for efficiency.'"[336]

> Ultimately, for a content-neutral regulation "'to be narrowly tailored, it must not burden substantially more speech than is necessary to further the government's legitimate interests.'" While this does not require that a subject regulation "'be the least restrictive or least intrusive means of' serving the government's interests, . . . the government still 'may not regulate expression in such a manner that a substantial portion of the burden on speech does not serve to advance its goals.'"[337]

In *McCutcheon v. FEC*[338] the Court noted that in the First Amendment context, even if strict scrutiny is not required, a reasonable fit is necessary—"a fit . . . that represents not necessarily the single best disposition but one whose scope is 'in proportion to the interest served,' . . . that employs not necessarily the least restrictive means but . . . a means narrowly tailored to achieve the desired objective."[339] Thus, the burden is on the government enacting any speech-impinging law to present evidence that supports its need for the regulation, that the speech restriction materially advances an important or substantial interest and demonstrates that the harms that generated the regulation are real, and that the regulation will alleviate these harms in a direct and material way.[340]

An argument unsupported by evidence favoring a speech restriction will not carry the government's burden.[341] Courts demand evidence that the regulated conduct actually threatened the government's interests and will assess the viability of alternative means of advancing such interests.[342] The regulation in question must be properly calibrated to its justifying purpose.[343] This element of calibration goes to the very heart of the constitutional requirement that the regulation "not 'burden substantially more speech than is necessary to further the government's legitimate interests.'"[344]

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334 *Billups*, 194 F. Supp. 3d at 467 (citations omitted) (quoting McCullen v. Coakley, 134 S. Ct. 2518, 2534 (2014)).

335 *McCullen*, 134 S. Ct. at 2534.

336 *Id.* (alteration in original) (quoting Riley v. Nat'l Fed'n of Blind of N.C., Inc., 487 U.S. 781, 795 (1988)); *accord Billups*, 194 F. Supp. 3d at 467.

337 *Id.* at 467–68 (citations omitted) (quoting *McCullen*, 134 S. Ct. at 2535).

338 134 S. Ct. 1434 (2014).

339 *Id.* at 1456–57 (quoting Bd. of Trs. of State Univ. of N.Y. v. Fox, 492 U.S. 469, 480 (1989)).

340 Reynolds v. Middleton, 779 F.3d.222, 226–28 (4th Cir. 2015) (citing Ross v. Early, 746 F.3d 546, 555 (4th Cir. 2014), *cert. denied*, 135 S. Ct. 183 (2014)).

341 *See id.* at 228–29.

342 *See* McCullen v. Coakley, 134 S. Ct. 2518, 2540 (2014).

343 *Id.* at 2529 (quoting Ward v. Rock Against Racism, 491 U.S. 781, 791 (1989)).

344 *Id.* at 2535 (quoting *Ward*, 491 U.S. at 799).

In *McCullen v. Coakley*[345] the Court applied an intermediate scrutiny standard to conclude that the statute at issue was not narrowly tailored.[346] The Court grounded its conclusion in the fact that the Commonwealth of Massachusetts provided no evidence supporting its arguments.[347] It was not sufficient justification to state that other approaches had not worked.[348]

F. *The Need for Empirical Data on the Educational Content of Charitable Solicitations*

In reviewing the fundraising appeals in the *Cancer Fund of America*[349] case, the insignificance of the educational components of the solicitation message is surprising. Remember that the litigation was not against the fundraising firms but the sham charities that, presumably, controlled the content of the message.[350] The lesson of *McCullen* and other cases is that empirical data or other evidence will be necessary to convince a court to apply an intermediate scrutiny standard and uphold the legislation.

There is a need for social scientists to devise studies that can measure and evaluate the educational content of solicitations and the attitudes of recipients who receive them. Surveys are necessary to analyze the speech, measuring its content and whether recipients reacted, read, or even noticed the educational components. Studies of donors and recipients of requests for funds may enable the introduction of credible and persuasive evidence that in the context of the total solicitation, the educational part of the message is irrelevant. Such empirical evidence could be used to reinforce the fact that the purported charity is using the solicitation for the private benefit of the insiders, the fundraising firm, or others. It may be that the results of such research will force charities and their fundraising firms to provide more serious educational content in their solicitations. That would be a positive result.

CONCLUSION

This Article has maintained that the reality of fundraising speech, in most cases, is commercial in nature, not educational. This contrasts with the Supreme Court's view that the educational component of a solicitation is always intertwined with the commercial part of the message, justifying a strict

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345 134 S. Ct. 2518 (2014).

346 *See id.* at 2534, 2539.

347 *Id.* at 2539.

348 *Id.* at 2539–40 (a regulation making it a crime to knowingly stand on a public way or sidewalk, other than a hospital, where abortions were performed was not narrowly tailored to serve a governmental interest and therefore violated free speech guarantees).

349 Case No. 2:15-cv-00884-NVW (D. Ariz. 2015).

350 *See, e.g.*, Complaint at 21–26, FTC v. Cancer Fund of America, 2:15-cv-00884-NVW (D. Ariz. 2015).

scrutiny standard of review whenever a regulation impinges on fundraising speech. If a tax-exempt organization does not carry on a charitable program commensurate in scope with its financial resources, regulators should be able to withdraw the benefits of exemption to the organization or its donors. One approach should be to disallow the donors' deductions for their contributions normally permitted by law, which under *Regan* would not run afoul of constitutional requirements.

In reviewing regulatory efforts, courts should apply an intermediate standard of review that will allow a balancing of the state's interest in ensuring the honesty of charities with the impact on the charity's rights of speech. Application of an intermediate standard of scrutiny allows regulators to oversee more easily those few charities and professional solicitors who consciously evade the law and will enable the courts more easily to reach a just result, which will benefit the nonprofit sector, the donating public, and the beneficiaries of charities' activities.