

NEW YORK UNIVERSITY  
JOURNAL OF LAW & BUSINESS

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VOLUME 11

SPRING 2015

NUMBER 3

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CHARITABLE SOLICITATION ACTS: MASLOW'S  
HAMMER FOR REGULATING SOCIAL  
ENTERPRISE

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*Since 2008, more than half the states in the United States have passed enabling legislation authorizing a variety of social enterprise corporate forms. Organizations adopting these forms are required to identify social or environmental purposes in addition to the traditional corporate purpose of creating shareholder wealth. In the rush to authorize these innovative corporate forms, however, the question of how the social or environmental purposes of these organizations will be regulated and enforced is often overlooked. The absence of effective regulation in this space fosters investor uncertainty, thereby inhibiting the growth and scale of the nascent social enterprise sector.*

*Recently, state charity regulators have turned their attention to social enterprise. Some have suggested that these new corporate forms fall under the purview of existing nonprofit regulatory regimes, specifically, state charitable solicitation acts. This Article focuses on the intersection of newly authorized social enterprise forms and charitable solicitation acts. To that end, this Article begins by summarizing the current landscape of social enterprise regulation. Part I reviews the history and purpose of charitable solicitation acts. Part II analyzes three fundamental issues in the context of charitable solicitation regulation: (1) are social enterprises "charitable organizations"; (2) do social enterprises "solicit" charitable contributions; and (3) are social enterprises "commercial co-venturers"? Based on this analysis, this Article concludes that subjecting social enterprise to charitable solicitation regula-*

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\* Copyright © 2015 by Robert T. Esposito. Impact Finance Fellow, Orrick, Herrington & Sutcliffe LLP; Jacobson Fellow in Law & Social Enterprise, 2013–2014, New York University School of Law. I am deeply grateful for the support of the Jacobson Leadership Program in Law & Business and to those that offered their time and insight into the topics discussed in this Article, especially Karen Brenner, John J. Fishman, Seth Henry, Haskell Murray, Shawn Pelsinger, Dana Brakman Reiser, Helen Scott, and Naveen Thomas. All opinions and errors are my own.

*tion is inconsistent with legislative intent, fails to establish an effective enforcement mechanism to hold social enterprises accountable to their stated social and environmental goals, and risks stifling growth in the social enterprise sector. Regulators and lawmakers alike should avoid attempts to shoehorn these organizations into outdated and ineffective nonprofit regulatory regimes. Instead, they should recognize that social enterprise requires its own regulatory framework that is tailored to the innovative corporate purposes these organizations pursue and fosters a more certain regulatory environment in which they can operate.*

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#### INTRODUCTION

*"I suppose it is tempting, if the only tool you have is a hammer, to treat everything as if it were a nail."<sup>1</sup>*

In recent years, corporate law has witnessed unprecedented innovation in the types of corporate forms available to business enterprises. These new legal structures are collectively

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1. ABRAHAM MASLOW, *THE PSYCHOLOGY OF SCIENCE: A RECONNAISSANCE* 15 (1969). This maxim is often referred to as "Maslow's Hammer" or the "law of the instrument." See also ABRAHAM KAPLAN, *THE CONDUCT OF INQUIRY: METHODOLOGY FOR BEHAVIORAL SCIENCE* 29 (1964) ("I call it the *law of the instrument*, and it may be formulated as follows: Give a small boy a hammer, and he will find that everything he encounters needs pounding.").

known as social enterprises and include the benefit corporation, the benefit LLC (BLLC), the low-profit limited liability company (L3C), and the social purpose corporation (SPC).<sup>2</sup> The benefit corporation, now available in more than half the states, has been the most widely enacted of this group,<sup>3</sup> and over thirty U.S. jurisdictions now authorize at least one social enterprise form.<sup>4</sup> In general, these are for-profit corporate forms designed for businesses that seek to produce double- or triple-bottom lines instead of simply maximizing shareholder wealth.

The spread of social enterprise forms is due in large part to consistently broad bipartisan political support at the state level.<sup>5</sup> Take, for example, the benefit corporation. When legislation was first proposed in Maryland in 2010, it passed the House of Delegates by an overwhelming 125 to 13 vote, and unanimously passed the Senate before being signed into law by Democratic Governor Martin O'Malley.<sup>6</sup> Four years later, bipartisan support remains strong.<sup>7</sup> Benefit corporation legis-

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2. For a more comprehensive overview of these newly authorized corporate forms, see, for example, Robert T. Esposito, *The Social Enterprise Revolution in Corporate Law: Emerging Corporate Entities in Europe and the United States and the Case for the Benefit Corporation*, 4 WM. & MARY BUS. L. REV. 639 (2013); Cass Brewer, Elizabeth Carrott Minnigh & Robert A. Wexler, *Social Enterprise by Non-Profits and Hybrid Organizations*, No. 489-1st, Bloomberg BNA Portfolio (2014).

3. As of December 2014, benefit corporation legislation has been enacted in twenty-seven jurisdictions. See *Legislation*, B LAB, <https://www.bcorporation.net/what-are-b-corps/legislation> (last visited Dec. 9, 2014).

4. See SOCIAL ENTERPRISE LAW TRACKER, [www.socentlawtracker.org](http://www.socentlawtracker.org).

5. This is due to the successful lobbying efforts of B Lab, a Pennsylvania nonprofit organization that administers the "B Corporation" certification. For a discussion of the difference between B Lab's "B Corp" certification and "benefit corporations" that are now authorized by state corporate law, see Esposito, *supra* note 2, at 695–706.

6. S.B. 690/H.B. 1009, 2010 Leg., Reg. Sess. (Md. 2010). Both the House of Delegates and the Senate were controlled by the Democratic Party. See generally, *Maryland House of Delegates Elections 2010*, BALLOTPEDIA, [http://ballotpedia.org/Maryland\\_House\\_of\\_Delegates\\_elections\\_2010](http://ballotpedia.org/Maryland_House_of_Delegates_elections_2010) (last visited Feb. 12, 2015); *Maryland State Senate Elections 2010*, BALLOTPEDIA, [http://ballotpedia.org/Maryland\\_State\\_Senate\\_elections\\_2010](http://ballotpedia.org/Maryland_State_Senate_elections_2010) (last visited Feb. 12, 2015).

7. Compare to North Carolina, which is arguably the least friendly state for social enterprise. In 2013, the North Carolina House voted down proposed benefit corporation legislation by a 60 to 52 vote due to fears that the benefit corporation was "part of a secret conspiracy to promote the United

lation recently passed unanimously in both houses of the Utah legislature before being signed into law by Republican Governor Gary Herbert.<sup>8</sup> Proponents explain that these new corporate forms enjoy support from liberals because they “prove that business can be socially and environmentally responsible,”<sup>9</sup> and from conservatives because “it affords the free market, not government, as the solution to social and environmental problems.”<sup>10</sup>

However, the rush to pass social enterprise legislation has come at the expense of thoughtful deliberation about how to effectively regulate these entities, and how to enforce the social and environmental missions they purport to pursue. Dana Brakman Reiser has noted that, with the exception of Illinois,<sup>11</sup> L3C statutes “do not add any new layer of enforcement apparatus” and “do not empower any regulatory body to play a role in enforcement.”<sup>12</sup> Similarly, Reiser observes that

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Nations’ ‘Agenda 21’ sustainability efforts, which conspiracy theorists allege is actually a socialist plot.” See Laura Leslie, *House Votes Down Benefit Corporations*, WRAL.COM (May 15, 2013), <http://www.wral.com/house-votes-down-benefit-corporations/12451435/>; see also H.B. 440, 2013-2014 Sess. (N.C. 2013); S.B. 99, 2013-2014 Sess. (N.C. 2013). Furthermore, in 2014, the North Carolina legislature became the first to repeal L3C legislation. N.C. GEN. STAT. §§ 55D-20(a); 57C-2-01(d); 57C-2-21(a)(6) (2013), *repealed by* S.B. 439, 2013-2014 Sess. (N.C. 2014).

8. The Utah House passed S.B. 133, authorizing benefit corporations, by a vote of 70 to 0, and the Senate passed the bill by a vote of 26 to 0. See S.B. 133, Gen. Sess. (Utah 2014); S.B. 133, Gen. Sess. (Utah 2014). Both the House and the Senate were controlled by the Republican Party. For information on the Utah House and Senate, see <http://www.utahsenate.org/asp/roster.aspx>; <http://le.utah.gov/443/house2/representatives.jsp>.

9. Kyle Westaway, *New York Unanimously Passes Benefit Corporation Bill*, SOCENTLAW (July 6, 2011), <http://socentlaw.com/2011/07/new-york-unanimously-passes-benefit-corporation-bill/> (noting that the New York benefit corporation bill passed in the New York State legislature by a 62 to 0 vote in the Senate and a 139 to 0 vote in the Assembly).

10. *Id.*

11. The Illinois L3C statute remains the only one of its kind to explicitly address regulation of L3Cs. It declares that L3Cs and their chief operating officers, directors, and managers are “trustees” under Section 3 of the Illinois State Charitable Trust Act, thereby granting the Attorney General regulatory oversight over L3Cs and imposing additional reporting and disclosure requirements on these entities. See 805 ILL. COMP. STAT. 180/1-26(d) (2010); see also Dana Brakman Reiser, *Regulating Social Enterprise*, 14 U.C. DAVIS BUS. L.J. 231, 235 (2014).

12. Reiser, *supra* note 11, at 234-35; see also John A. Pearce II & Jamie Patrick Hopkins, *Regulation of L<sup>3</sup>Cs [sic] for Social Entrepreneurship: A*

California's SPC statute leaves regulators "out of the enforcement picture,"<sup>13</sup> and criticizes benefit corporation statutes as "rely[ing] heavily on investor enforcement."<sup>14</sup> Shruti Rana characterizes the current regulatory landscape as a "no-man's-land"<sup>15</sup> where social enterprise entities "may be regulated only by the good intentions of their founders and managers."<sup>16</sup>

Many observers agree that the current regulatory vacuum decreases investor confidence in these forms and inhibits the growth of the nascent social enterprise sector. Reiser concludes that without effective enforcement, "it is difficult to see how these entities can succeed as viable constructs for housing social enterprises."<sup>17</sup> Similarly, John A. Pearce II and Jamie Patrick Hopkins suggest that adoption of the L3C form has stalled due to "lack of government incentive and regulation."<sup>18</sup> Rana echoes these sentiments, arguing for "greater regulatory flexibility to keep up with, rather than lag behind market and philanthropic innovation."<sup>19</sup>

Recently, scholars and regulators alike have begun to heed these calls for regulation. Some suggest that social enterprise forms should be subject to existing nonprofit regulatory

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*Prerequisite to Increased Utilization*, 92 NEB. L. REV. 259, 283 (2013) ("[R]arely does government monitoring exist to ensure the L<sup>3</sup>C follows these requirements . . . thus exposing investors to needless uncertainty and potentially inhibiting federal lawmakers from granting L<sup>3</sup>Cs preferential treatment as PRI recipients.").

13. Reiser, *supra* note 11, at 236.

14. *Id.* at 237. Reiser also criticizes the effectiveness of the independent, third-party standards against which benefit corporations are statutorily required to measure themselves in their Annual Benefit Reports: "[I]ndividual benefit corporations must apply the third-party's standard to themselves. If a given benefit corporation finds itself able to make the grade, it qualifies for benefit corporation status. Thus, to the extent that third-party standard setters are added to the benefit corporation's enforcement picture, they play only a limited and indirect role." *Id.* at 238.

15. Shruti Rana, *Philanthropic Innovation and Creative Capitalism: A Historical and Comparative Perspective on Social Entrepreneurship and Corporate Social Responsibility*, 64 ALA. L. REV. 1121, 1146 (2013).

16. *Id.*

17. Reiser, *supra* note 11, at 240; *see also* Dana Brakman Reiser, *Theorizing Forms for Social Enterprise*, 62 EMORY L.J. 681, 706 (2013) ("[F]or a specialized form for social enterprise to lead social entrepreneurs to achieve [a] social mission, the form itself must provide a ready answer to the enforcement question. None of the current forms have yet accomplished this.").

18. Pearce & Hopkins, *supra* note 12, at 288.

19. Rana, *supra* note 15, at 1166.

regimes, specifically, that they be regulated under the common law of charitable trusts.<sup>20</sup> John Tyler persuasively argues against this proposal, emphasizing that subjecting social enterprises to charitable trust law would have “significant potential for negative consequences related to legislative intent and how charitable hybrids are financed and managed.”<sup>21</sup> Tyler explains that charitable trust regulation is inappropriate for the following reasons: (1) social enterprises have none of the tax benefits of charitable organizations, so they should not be subject to charitable trust law; (2) social enterprises are funded by investors who expect a return on their investment, not by charitable donations; and (3) social enterprises are competing in the same market as traditional for-profit enterprises for investors, and the imposition of charitable trust law will put these organizations at a competitive disadvantage.<sup>22</sup> Jill Manny concurs with Tyler’s analysis, but contends that it is unlikely regulators will apply charitable trust standards to social enterprises.<sup>23</sup> Indeed, Manny’s conclusion is supported by case law holding that charitable trust law is inapplicable to profit-distributing for-profit corporations.<sup>24</sup>

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20. John Tyler, *Analyzing Effects and Implications of Regulating Charitable Hybrid Forms as Charitable Trusts: Round Peg and a Square Hole?*, 9 N.Y.U. J.L. & Bus. 535, 538 (2013) (“One prominently discussed approach to regulating these new hybrid forms, specifically charitable ones, seeks to subject them to charitable trust laws.”). Tyler explains the rationale behind this proposal: “[T]he assertion is that the assets of charitable hybrids are themselves charitable, thereby requiring that the entities that hold them be treated as charitable trusts as a matter of law.” *Id.* at 567. See also Roxanne Cartwright, Michelle Limaj & Shirin Philipp (Foley Hoag LLP), *Massachusetts Charitable Registration Laws*, LAWFORCHANGE, <http://www.lawforchange.org/NewsBot.asp?MODE=VIEW&ID=3472> (last visited Sept. 22, 2014). (“Charities, including social enterprises, should be aware that there are laws governing the investment and spending of funds in general and endowments in particular and the use of assets subject to gift restrictions.”).

21. Tyler, *supra* note 20, at 538.

22. *Id.* at 536–44; see also Jill Manny, *Much Ado About Nothing: A Comment on Tyler’s Paper on Regulating Charitable Hybrids*, 9 N.Y.U. J.L. & Bus. 587, 597–98 (2013).

23. Manny, *supra* note 22, at 596.

24. See, e.g., *State v. Delano Comm. Dev. Corp.*, 571 N.W.2d 233, 238 (Minn. 1997) (rejecting the Minnesota Attorney General’s “unprecedented” request for a declaratory judgment seeking to impose charitable trust law on a community development corporation, emphasizing that the defendant was a for-profit corporation whose articles explicitly permitted profit distribution).

Thus far, the academic discussion surrounding social enterprise regulation has focused on the common law of charitable trusts and its attendant fiduciary duties. This Article argues that this focus is too narrow and overlooks statutory law regulating charitable organizations<sup>25</sup>—namely, state charitable solicitation acts, which have been enacted in forty-six jurisdictions.<sup>26</sup> In fact, the intersection of charitable solicitation acts and social enterprise was recently propelled into the spotlight by guidance issued in April 2014 by Colorado Secretary of State Scott Gessler.<sup>27</sup> The Secretary suggested that “even though [benefit corporations] are not tax-exempt and donations to them are not tax-deductible, some of these organizations may engage in charitable solicitations,”<sup>28</sup> and cautioned that benefit corporations may be required to register as “charitable organization[s]” under Colorado’s Charitable Solicitation Act.<sup>29</sup> This opinion, the first of its kind, has been criticized by social enterprise advocates as a “regulatory overreach” and has been blamed for the low adoption rate of the benefit corporation form in Colorado.<sup>30</sup> Moreover, it has shifted the discussion of social enterprise regulation away from the common law of charitable trusts and refocused the dialogue on charitable solicitation acts.

This Article examines the intersection of charitable solicitation acts and social enterprise forms, and analyzes whether

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25. Cf. Cassidy V. Brewer, *Seven Ways to Strengthen and Improve the L3C*, 25 REGENT U. L. REV. 329, 342–45 (2013) (proposing that L3Cs be required to register under state charitable solicitation acts).

26. For a list of the forty-six jurisdictions, see *infra* note 37.

27. *Business FAQs: Public Benefit Corporations*, COLORADO SEC’Y OF STATE, <http://www.sos.state.co.us/pubs/business/FAQs/pbc.html> (last visited Sept. 22, 2014). See also Brewer, *supra* note 25, at 342–45 (proposing that L3Cs be required to register under state charitable solicitation acts).

28. *Public Benefit Corporations and Benefit Corporations FAQs*, COLORADO SEC’Y OF STATE, <http://www.sos.state.co.us/pubs/charities/instructions/PBC.html> (last visited Sept. 22, 2014). The Secretary’s guidance does not explain why for-profit organizations that are not tax-exempt and are not eligible to receive tax-deductible donations would, nevertheless, solicit charitable donations.

29. *Id.*

30. Steve Lynn, *Gessler Rule Stifles B Corp Signups*, BIZWEST, <http://bizwest.com/gessler-rule-stifles-b-corp-signups-13/> (last visited Sept. 22, 2014). In the first three months after the Colorado benefit corporation statute became effective, only fifty-five companies registered as benefit corporations there, compared to over 250 in Nevada. *Id.*

these new legal structures may be subject to charitable solicitation regulation. To that end, Part I discusses the history and purpose of charitable solicitation acts, and briefly summarizes the registration and reporting requirements they impose on charities and their partner organizations. Part II analyzes whether charitable solicitation acts may be applied to social enterprise forms by asking three fundamental questions: (1) are social enterprises “charitable organizations”; (2) do social enterprises “solicit” charitable funds; and (3) are social enterprises “commercial co-venturers”? Part II also argues that using charitable solicitation acts to regulate social enterprise exemplifies psychologist Abraham Maslow’s famous maxim: “I suppose it is tempting, if the only tool you have is a hammer, to treat everything as if it were a nail.”<sup>31</sup> In other words, charitable solicitation acts are the wrong regulatory tools to achieve the legitimate end of fostering an effective regulatory environment for social enterprise. This Article concludes that such a regulatory approach is inconsistent with the legislative intent of these acts, does not solve the problem of effective enforcement of social enterprise forms, and risks stifling continued innovation in the emerging social enterprise sector.

## I.

### STATE CHARITABLE SOLICITATION ACTS

#### A. *A Brief History of Charitable Solicitation Acts*

State regulation of charitable solicitation began in 1943, when New Hampshire became the first state to require charities to register with the Attorney General.<sup>32</sup> In 1953 and 1954, due in large part to the efforts of the Joint Legislative Committee on Charitable and Philanthropic Agencies chaired by New York State Senator Bernard Tompkins, highly publicized

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31. MASLOW, *supra* note 1.

32. 1943 N.H. Laws 181, reprinted in *Recommending State Supervision of Charitable Trusts*, 23 IND. L.J. 141, 153–56 (1948); Melissa G. Liazos, *Can States Impose Registration Requirements on Online Charitable Solicitors?*, 67 U. CHI. L. REV. 1379, 1384 (2000). For a more comprehensive history of the development of public policy and regulation of charitable solicitation in the United States, see Putnam Barber, *Regulation of Charitable Solicitations in the United States of America* (July 7–10, 2010) (unpublished manuscript); Putnam Barber, *Regulation of U.S. Charitable Solicitations Since 1954*, 23 VOLUNTAS: INT’L J. OF VOLUNTARY AND NONPROFIT ORGS 737–62 (2012) [hereinafter Barber, 1954].

“charity rackets” led to the increased adoption of charitable solicitation statutes.<sup>33</sup> By 1959, twenty-one jurisdictions had passed similar legislation.<sup>34</sup>

Support for state regulation of charitable solicitation continued after the Hamlin Committee, with support from the Rockefeller Foundation, published a favorable report in 1961 entitled *Voluntary Health and Welfare Organizations in the United States: An Exploratory Study by an Ad Hoc Citizens Committee*.<sup>35</sup> By 1986 an overwhelming majority of states had enacted charitable solicitation acts and, in an effort to promote uniformity, the National Association of Attorneys General (NAAG) and the National Association of State Charities Officials (NASCO) promulgated *A Model Act Concerning the Solicitation of Funds for Charitable Purposes* (1986 Model Act).<sup>36</sup> As of 2014, forty-five states and the District of Columbia regulate charitable solicitation.<sup>37</sup>

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33. Barber, 1954, *supra* note 32, at 746. The Final Report of the Joint Legislative Committee on Charitable and Philanthropic Agencies concludes as follows: “The generosity of our citizens has been consistently and flagrantly abused by a small minority of frauds operating as ‘charities’ which have mulcted New Yorkers out of an annual amount probably in excess of \$25,000,000. In addition, an even vaster sum of dollars contributed by the public is cut down to pennies before reaching the intended beneficiaries by excessive fund raising and administrative costs of inefficient charities.” See also JAMES FISHMAN & STEPHEN SCHWARTZ, *NONPROFIT ORGANIZATIONS* 270 (3rd ed. 2006) (“In response to the problems created by unscrupulous charitable solicitors, a majority of states have developed elaborate registration and filing systems requiring charities and fundraising solicitors to register, file annual reports, and notify the state of any changes in their status.”); SCOTT M. CUTLIP, *FUNDRAISING IN THE UNITED STATES: ITS ROLES IN AMERICAN PHILANTHROPY* 441–44 (rev. ed. 1990).

34. Barber, 1954, *supra* note 32, at 746.

35. ROBERT H. HAMLIN, *VOLUNTARY HEALTH AND WELFARE ORGANIZATIONS IN THE UNITED STATES: AN EXPLORATORY STUDY BY AN AD HOC CITIZENS COMMITTEE* (1961).

36. *A MODEL ACT CONCERNING THE SOLICITATION OF FUNDS FOR CHARITABLE PURPOSES* (1986) [hereinafter 1986 MODEL ACT], available at <http://www.nasconet.org/wp-content/uploads/2011/05/Model-Law-for-charitable-solicitations.pdf> (last visited Sept. 21, 2014).

37. ALA. CODE §§ 13A-9-80 to -84 (2013); ALASKA STAT. §§ 45.68.101 to -900 (2013); AZ. REV. STAT. §§ 44-6551 to -6561 (2013); ARK. CODE ANN. §§ 4-28-401 to -416 (2013); CAL. GOV’T CODE §§ 12580–12599.8 (2013); COLO. REV. STAT. ANN. §§ 6-16-101 to -114 (2013); CT. GEN. STAT. ANN. §§ 21a-175 to -190(l) (2013); DEL. CODE ANN. tit 6, §§ 2591 to 2597 (2013); D.C. CODE ANN. §§ 44-1701 to -1714 (2013); FLA. STAT. ANN. §§ 496.401 to -424 (2013); GA. CODE ANN. §§ 43-17-1 to -17-23 (2013); HAW. REV. STAT.

Historically, charitable solicitation acts shared three fundamental elements: (1) they required annual registration and public financial disclosure from charities; (2) they made unlawful certain fraudulent fundraising activities; and, for a time, (3) they imposed percentage-based limitations on the costs of fundraising expenses.<sup>38</sup> In theory, these elements served two purposes: public disclosure and fraud prevention.<sup>39</sup> The rationale behind this regulatory approach is that requiring registra-

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§§ 467B-1 to -17 (2013); 255 ILL. COMP. STAT. ANN. ch. 225, §§ 460/0.01 to 460/23 (2013); ANN. IND. CODE §§ 23-7-8-1 to -9 (2013); IOWA CODE ANN. §§ 13C.1 to 13C.8 (2013); KAN. STAT. ANN. 17-1759 to -1776 (2013); KY. REV. STAT. ANN. §§ 367.650 to -670 (2013); LA. REV. STAT. 51:1901 to -1909.1 (2013); ME. REV. STAT. ANN. tit. 9 §§ 5001 to 5019 (2013); MD. CODE ANN., BUS. REG. §§ 6-101 to -6-7 (2013); MASS. STAT. ch. 68, §§ 18-35 (2013); MICH. COMP. LAWS ANN. §§ 14.301 to -.327 (2013); MINN. STAT. ANN. §§ 309.50 to -.61 (2013); MISS. CODE ANN. §§79-11-501 to -529 (2013); MO. REV. STAT. §§ 407.450 to -.478 (2013); N.H. REV. STAT. ANN. §§ 7:19 to -:32-b (2013); N.J. STAT. ANN. §§ 45:17A-18 to -40 (2013); NEW MEX. STAT. ANN. §§ 57-22-1 to -11 (2013); N.Y. EXEC. §§ 171-a to -177 (McKinney 2013); N.C. GEN. STAT. ANN. §§ 131F-1 to -3 (2013); N.D. CENT. CODE §§ 50-22-01 to -07 (2013); OHIO REV. CODE ANN. §§ 1716.01 to -.99 (2013); OK. STAT. ANN. tit. 18 §§ 552.1 to -.22 (2013); OR. REV. STAT. §§ 128.801 to -.898 (2013); PA. CONS. STAT. §§ 162.1 to -.23 (2013); R.I. GEN. LAWS §§ 5-53.1-1 to -.1-18 (2013); S.C. CODE ANN. §§ 33-56-10 to -200 (2013); TENN. CODE ANN. §§ 48-101-501 to -522 (2013); UT. CODE ANN. §§ 13-22-1 to -23 (2013); VT. STAT. ANN. tit. 9 §§ 2471 to 2479 (2013); VA. CODE ANN. §§ 57-48 to -69 (2013); WASH. REV. CODE 19.09.010 to -.100 (2013); W.V. CODE ANN. § 29-19-1 to -15a (2013); WISC. STAT. ANN. §§ 440.41 to -.48 (2013). Idaho, Montana, Nebraska, South Dakota and Wyoming are the only states that have either not enacted, or repealed, charitable solicitation statutes.

38. FISHMAN & SCHWARTZ, *supra* note 33, at 270.

39. Suzanne Ross McDowell, *Exempt Organizations' Use of the Internet*, TAX EXEMPT CHARITABLE ORGANIZATIONS (ALI-ABA 2003), at \*25 (“Charitable solicitation statutes serve two purposes: to allow the public to get basic information about organizations asking for contributions so donors can make better charitable giving decisions; and to protect the public from charitable solicitation fraud and misrepresentations.”); Charles Nave, *Charitable State Registration and the Dormant Commerce Clause*, 31 WM. MITCHELL L. REV. 227, 227-28 (2004) (“Although the states posit various justifications for these statutes, they typically boil down to two main reasons: public disclosure and fraud prevention.”); Karl E. Emerson, *State Solicitation Requirements*, 23RD ANNUAL REPRESENTING AND MANAGING TAX-EXEMPT ORGANIZATIONS, 2006 WL 5839022 at \*1-2 (2006) (“These state solicitation statutes generally serve at least two important purposes. First, they enable donors to obtain basic information about organizations asking for contributions so the donors can make more informed charitable giving decisions . . . [and] they help protect donors from charitable solicitation fraud and misrepresentations.”).

tion and public disclosure of financial reports fosters a more informed donating public, thereby reducing the scope and frequency of fraudulent fundraising. However, it was the inclusion of percentage-based limitations on fundraising that became the most contentious element of charitable solicitation acts.

### B. *Charitable Solicitation Acts and the First Amendment*

Charitable solicitation acts briefly gained high-profile status in the 1980s when charities successfully challenged the use of percentage-based limitations on fundraising costs on First Amendment grounds.<sup>40</sup> Prior to 1980, states used a simplistic fundraising cost ratio to determine whether or not a charity fraudulently solicited charitable funds.<sup>41</sup> The challenges brought during the 1980s resulted in the so-called *Riley* trilogy<sup>42</sup> in which the Supreme Court consistently struck down regulations imposing percentage-based limitations on fundraising and point-of-solicitation disclosure requirements.

The *Riley* trilogy began with the case of *Village of Schaumburg v. Citizens for a Better Environment*.<sup>43</sup> In *Schaumburg*, the Supreme Court held that the Village's municipal ordinance prohibiting the solicitation of donations by charitable organizations that do not use at least 75% of their gross receipts for "charitable purposes" was an unconstitutionally overbroad regulation of solicitors' free speech rights.<sup>44</sup> Writing for the 8 to 1 majority, Justice White emphasized that soliciting

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40. BRUCE R. HOPKINS, *THE LAW OF FUNDRAISING* 107 (4th ed. 2009).

41. *Id.* at 36 ("It was a simplistic approach that was not always fair.").

42. For a more detailed analysis of the *Riley* trilogy, and the constitutional issues surrounding charitable fundraising, see, for example, BRUCE R. HOPKINS, *TAX-EXEMPT ORGANIZATIONS AND CONSTITUTIONAL LAW: NONPROFIT LAW AS SHAPED BY THE U.S. SUPREME COURT* 215–50 (2012); FISHMAN & SCHWARTZ, *supra* note 33, at 295–311; Elaine Waterhouse Wilson, *State Regulation of Charitable Solicitation*, 12 *PROB. & PROP.* 49 (1998); Errol Copilevitz, *The Historical Role of the First Amendment in Charitable Appeals*, 27 *STETSON L. REV.* 457 (1997).

43. 444 U.S. 620 (1980).

44. *Id.* at 636 ("We agree with the Court of Appeals that the 75-percent limitation is a direct and substantial limitation on protected activity that cannot be sustained unless it serves a sufficiently strong, subordinating interest that the Village is entitled to protect. We also agree that the Village's proffered justifications are inadequate and that the ordinance cannot survive scrutiny under the First Amendment.").

charitable donations is not merely commercial speech, but rather, is “intertwined with informative and perhaps persuasive speech seeking support for particular causes or for particular views.”<sup>45</sup> Accordingly, the Court concluded that charitable solicitations fell well within the purview of protected speech under the First Amendment and struck down the percentage-based limitation as unconstitutional.

Four years later, a similar percentage-based limitation on fundraising was struck down in *Secretary of State of Maryland v. Joseph H. Munson Co.*<sup>46</sup> In *Munson*, the Supreme Court extended its ruling in *Schaumburg*, holding that percentage-based limitations were constitutionally impermissible even where the statute provided an administrative waiver for charities that demonstrated financial necessity.<sup>47</sup> The final blow to percentage-based limitations came in *Riley v. National Federation of the Blind of North Carolina*,<sup>48</sup> in which the Supreme Court struck down provisions of the North Carolina Charitable Solicitations Act that prohibited fundraisers from charging “unreasonable” fees, defined as anything exceeding 20% of gross receipts. Reaffirming the Court’s decisions in *Schaumburg* and *Munson*, the *Riley* court emphasized that “[u]sing percentages to decide the legality of the fundraiser’s fee is not narrowly tailored to the State’s interest in preventing fraud.”<sup>49</sup>

In the wake of the *Riley* trilogy, lower courts have been bound by precedent to strike down unconstitutionally overbroad regulations of protected speech.<sup>50</sup> However, the scope of *Riley* and its progeny has been limited to free speech issues.

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45. *Id.* at 632.

46. 467 U.S. 947 (1984).

47. *Id.* at 968 (“The 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. We conclude that, regardless of the waiver provision, *Schaumburg* requires that the percentage limitation in the Maryland statute be rejected.”).

48. 487 U.S. 781 (1988).

49. *Id.* at 789.

50. Hopkins has characterized these cases as “the single most important bar to more stringent government regulation of the process of soliciting charitable contributions.” HOPKINS, *supra* note 40, at 107. This applies equally to point-of-disclosure requirements, which were struck down as unconstitutionally compelled speech as a result of the *Riley* decision. See William M. Howard, Annotation, *Constitutional Challenges to Compelled Speech—Particular Situations or Circumstances*, 73 A.L.R. 6th 281 (2012).

Importantly, courts have left intact the other fundamental features of state charitable solicitation acts, including annual registration and financial disclosure requirements.<sup>51</sup> It is these remaining requirements, and the specter of Attorney General enforcement actions, to which this Article turns to next.

### C. *Registration and Reporting Requirements*

#### 1. *For Charitable Organizations*

The most fundamental element of charitable solicitation acts is the requirement that charitable organizations register annually with the appropriate governmental agency in each jurisdiction in which they intend to solicit donations.<sup>52</sup> This requirement applies to domestic and foreign charitable organizations alike.<sup>53</sup> Importantly, the registration requirement is triggered by the act of soliciting, not by the receipt of donated funds.<sup>54</sup> Therefore, charitable organizations must satisfy the registration requirement in each jurisdiction in which they intend to solicit funds *before* they actually do so.

However, due to the lack of uniformity among charitable solicitation acts, even this seemingly straightforward registration requirement becomes burdensome when a charity intends to solicit funds in multiple jurisdictions.<sup>55</sup> Simply main-

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51. *See, e.g.*, *Dayton Area Visually Impaired Persons, Inc. v. Fisher*, 70 F.3d 1474 (6th Cir. 1995); *American Target Advertising, Inc. v. Giani*, 23 F.Supp.2d 1303 (D. Utah 1998) (upholding registration fees and bond requirements). As Hopkins observes: “It is nonetheless clear that the basic features of a state’s charitable solicitation act will pass constitutional law muster.” HOPKINS, *supra* note 40, at 128.

52. HOPKINS, *supra* note 40, at 56.

53. *See id.*

54. *See, e.g.*, CT. GEN. STAT. ANN. § 21a-190b(a) (“Every charitable organization not exempted by section 21a-190d shall annually register with the department prior to conducting any solicitation or prior to having any solicitation conducted on its behalf by others.”); *see also* Emerson, *supra* note 39, at \*3.

55. As Charles Nave explains, maintaining compliance with registration and filing requirements is further complicated by local and municipal ordinances regulating charitable solicitations:

Six jurisdictions require charities to engage registered agents located within their borders even though the charity has no contact with the jurisdiction other than soliciting contributions from its residents. And many jurisdictions require charities to register as foreign corporations merely because they solicit residents through direct mail, telemarketing, or the Internet. Finally, localities are free

taining registration can be a daunting task, as the length of registration periods varies widely, from one year after the date of registration, to the end of the calendar year, to the end of the organization's fiscal year, depending on the jurisdiction.<sup>56</sup> Moreover, charitable organizations are also required to file annual financial disclosure statements covering the preceding accounting period, prepared pursuant to appropriate accounting standards.<sup>57</sup> These annual financial reports also lack uniformity, as Hopkins explains:

The annual report is due at varying time as required by the states' charitable solicitation statutes. The filing may have to be made within 30 days after the close of the accounting period, within 60 days of that period, within 75 days of the period, within 90 days of the period, within five months of the period, or within six months of the period.<sup>58</sup>

As a result, soliciting in multiple jurisdictions requires constant vigilance to ensure compliance with annual registration and reporting requirements.

## 2. *The Unified Registration Statement*

By 1998, the increasing complexity of registration requirements prompted NASCO and NAAG to promulgate the Unified Registration Statement (URS).<sup>59</sup> The URS is an effort to consolidate and streamline the registration requirements of all states that require registration by charitable organizations.<sup>60</sup> Since its introduction, the URS has made some pro-

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to enact their own charitable solicitation ordinances requiring registration as well.

Nave, *supra* note 39, at 231–32.

56. HOPKINS, *supra* note 40, at 58.

57. See, e.g., N.J. STAT. ANN. § 45:17A-24(d); see also HOPKINS, *supra* note 40, at 60.

58. HOPKINS, *supra* note 40, at 60. Hopkins also suggests that a “combination of intricacy and nonconformity makes this a body of law with which it is difficult to comply—a problem aggravated by a disparity in regulations, rules, and forms.” *Id.* at 48.

59. *Standardized Registration for Nonprofit Organizations Under State Charitable Solicitation Laws v.4.02*, NAT'L ASS'N OF ATT'YS. GEN. & NAT'L ASS'N OF STATE CHARITY OFFICIALS, [http://www.multistatefiling.org/urs\\_web\\_v402.pdf](http://www.multistatefiling.org/urs_web_v402.pdf) (last visited Sept. 26, 2014).

60. MULTI-STATE FILER PROJECT, THE UNIFIED REGISTRATION STATEMENT, <http://www.multistatefiling.org/> (last visited Sept. 26, 2014).

gress in simplifying the dizzying array of registration requirements, but has fallen far short of its goal of unifying registration nationwide.

As of 2014, thirty-six states and the District of Columbia accept the URS as an alternative form of satisfying the registration requirement imposed by their charitable solicitation acts.<sup>61</sup> However, attempts to achieve uniform registration have been undercut by these same states, which often require charities to file additional documents, or state-specific forms, in connection with a URS filing. As Jamie Usry explains:

All [jurisdictions accepting the URS] require some sort of supplemental documents: 97% require the previous year's Form 990; 86% require a copy of the IRS determination letter; 69% require a copy of the certificate of incorporation; and 64% require the previous year's financial audit documents. Still further complicating the URS, 25% of the states who [sic] have amended URS acceptance into their laws still require supplemental application forms.<sup>62</sup>

Furthermore, the URS addresses initial registration only. Hopkins emphasizes that “[o]nce registered, even under this uniform approach, a fundraising charitable organization is on its own in connection with annual reporting.”<sup>63</sup> Thus, despite the good intentions of URS drafters, the registration and financial reporting requirements imposed by charitable solicitation acts remains a confusing patchwork of state-specific laws, leaving charitable organizations to confront a “bewildering array of differing legal requirements, forms and due dates for filings . . . .”<sup>64</sup>

### 3. *For Commercial Co-Venturers*

The reach of charitable solicitation acts is not limited to charities. In fact, many charitable solicitation acts regulate for-profit organizations that partner with charities to engage in

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61. *Id.*

62. Jamie Usry, *Charitable Solicitation with the Nonprofit Sector: Paving the Regulatory Landscape for Future Success* (Univ. of Utah Ctr. for Pub. Policy & Admin., Policy Paper, July 30, 2008).

63. HOPKINS, *supra* note 40, at 78.

64. *Id.* at xi.

charitable sales promotions,<sup>65</sup> also known as cause-related marketing.<sup>66</sup> These for-profit organizations are regulated as “commercial co-venturers” (CCVs)<sup>67</sup> in twenty jurisdictions.<sup>68</sup> Importantly, these regulations are triggered by representations made to the public, not by the actual purchase of goods or services. Thus, CCVs must ensure that they satisfy these regulatory requirements *before* engaging in a charitable sales promotion, and in some instances, legal obligations extend years after a promotion ends.

Charitable sales promotions trace their roots to a 1983 American Express campaign supporting the Statue of Liberty Restoration Project, in which American Express promised to donate one cent for each transaction and one dollar for each

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65. See 1986 MODEL ACT, *supra* note 36, § 1(i) (defining charitable sales promotion as “[a]n advertising or sales campaign conducted by a commercial co-venturer, which represents that the purchase or use of goods or services offered by the commercial co-venturer will benefit, in whole or in part, a charitable organization or purpose”).

66. Matthew Berglind & Cheryl Nakata, *Cause-Related Marketing: More Buck than Bang?*, 48 Bus. Horizons 443, 444–45 (2005). See also, Edward B. Chansky, *For Goodness Sake: Legal Regulation and Best Practices in the Field of Cause-Related Marketing*, 28 N.Y.S.B.A. INSIDE 13, 13 (2010) (defining cause-related marketing as “a technique linking marketing with a social cause”); Sarah Dadush, *Profiting in (Red): The Need for Enhanced Transparency in Cause-Related Marketing*, 42 N.Y.U. J. INT’L L. & POL. 1269 (2010); Jessica Horne, *Pink Profiteers: Cause-Related Marketing and the Exploitation of Consumers’ Consciences*, 81 GEO. WASH. L. REV. 223 (2013). The term “embedded giving” has also been used to portray this type of fundraising model. HOPKINS, *supra* note 40, at 67.

67. See 1986 MODEL ACT, *supra* note 36, § 1(h) (defining commercial co-venturer as “a person who for profit is regularly and primarily engaged in trade or commerce other than in connection with soliciting for charitable organizations or purposes and who conducts a charitable sales promotion”).

68. ARK. CODE ANN. § 4-28-408 (2013); CAL. GOV’T CODE § 12599.2 (2013); CT. GEN. STAT. ANN. § 21a-190g (2013); FLA. STAT. ANN. § 496.414 (2013); GA. CODE ANN. § 43-17-6 (2013); HAW. REV. STAT. § 467B-5.5 (2013); LA. REV. STAT. 51:1901.2 (2013); MASS. STAT. ch. 68 § 24 (2013); MISS. CODE ANN. § 79-11-515 (2013); N.H. REV. STAT. § 7:28-d (2013); N.J. STAT. ANN. § 45:17A-29 (2013); N.Y. EXEC. §§ 173, 174 (2013); N.C. GEN. STAT. ANN. § 131F-18 (2013); OHIO REV. CODE ANN. § 1716.09 (2013); OR. REV. STAT. §§ 128.848, 128.856 (2013); S.C. CODE ANN. §§ 33-56-70, -110 (2013); TENN. CODE ANN. § 48-101-519 (2013); UT. CODE ANN. § 13-22-22 (2013); VA. CODE ANN. § 57-61.2 (2013); WISC. STAT. ANN. § 202.15 (2013). See also Esposito, *supra* note 2.

new card issued to the Restoration Project.<sup>69</sup> The campaign was hugely successful for both the Restoration Project and American Express: it raised over \$1 million for the cause, and resulted in a 28% increase in American Express card usage and a 17% increase in card applications.<sup>70</sup> Since 1983, such campaigns have become ubiquitous in American retail outlets. Indeed, the past three decades have witnessed exponential growth in corporate contributions from charitable sales promotions, which have increased from \$1 million to nearly \$1 billion annually.<sup>71</sup>

Despite the increase in charitable donations that result from these commercial partnerships, states have not adopted uniform regulatory requirements for CCVs. In fact, regulation of CCVs suffers from greater nonconformity than the registration and reporting requirements imposed on charities. In four states, CCVs, like charities, are required to register with the state prior to conducting a charitable sales promotion.<sup>72</sup> In eleven states, CCVs are required to disclose in each advertisement the amount or percentage from each good or service purchased or used that will benefit charity.<sup>73</sup> Seventeen states require that CCVs keep a final accounting of each charitable sales promotion for a period of three years, and make the ac-

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69. Berglind & Nakata, *supra* note 66, at 445; Horne, *supra* note 66, at 227.

70. Berglind & Nakata, *supra* note 66, at 445; Horne, *supra* note 66, at 227.

71. Berglind & Nakata, *supra* note 66, at 445; Horne, *supra* note 66, at 227. *See also* AUGUST HORVATH ET AL., ABA CONSUMER PROTECTION LAW DEVELOPMENTS 216–18 (2009). Some notable examples of cause-related marketing campaigns include Susan G. Komen for the Cure pink ribbons and (Product) RED. *See* SUSAN G. KOMEN, <http://ww5.komen.org/> (last visited Feb. 12, 2015).

72. ALA CODE § 13A-9-71(h) (2014) (requiring a \$100 annual registration fee); CAL. GOV'T CODE §§ 12599.2(c) (West 2014) (requiring a \$350 annual registration fee); MASS. GEN. LAWS ch. 68, § 24(a) (2014) (requiring a \$200 annual registration fee); S.C. CODE ANN. § 33-56-110(A) (2014) (requiring a \$50 annual registration fee).

73. ALA CODE ANN. § 13A-9-81 (2014); ARK. CODE ANN. § 4-28-408(c)(1) (2014); COLO. REV. STAT. ANN. 6-16-110(2) (2014); CT. GEN. STAT. ANN. § 21a-190g(c) (2014); LA. REV. STAT. 51:1901.2(B) (2014); N.H. REV. STAT. § 7:28-d(IV) (2014); N.J. STAT. ANN. § 45:17A-29(d) (2014); N.Y. EXEC. LAWS § 174-c (2014); OHIO REV. STAT. ANN. § 1716.09(b) (2014); UT. CODE ANN. § 13-22-22(4) (2014); WISC. STAT. ANN. § 202.15 (2014).

counting available upon request.<sup>74</sup> Eighteen states require CCVs to obtain a written contract with the charity with which they partner prior to engaging in a charitable sales promotion,<sup>75</sup> and six of these states require that the contract be filed with the state.<sup>76</sup> Finally, in Alabama and Massachusetts, CCVs must post a bond in the amount of \$10,000 and \$25,000, respectively, prior to engaging in a charitable sales promotion campaign.<sup>77</sup>

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74. ALA. CODE ANN. § 13A-9-71(h)(3) (2014) (requiring that the CCV retain a final accounting for only two years); ARK. CODE ANN. § 4-28-408(b) (2014); CAL GOV'T CODE §§ 12599.2(b)(2), (3) (2014); CT. GEN. STAT. ANN. § 21a-190g(b) (2014); FLA. STAT. ANN. § 496.414(2) (2014); GA. CODE ANN. 43-17-6(b) (2014); HAW. REV. STAT. § 467B-5-5.5(c) (2014); LA. REV. STAT. 51:1901.2(C) (2014); MASS. STAT. ch. 68, § 24(c) (2014) (requiring that CCVs also file an annual financial report, co-signed by the charity, with the Massachusetts Attorney General, Division of Public Charities); N.H. REV. STAT. § 7:28-d(III) (2014); N.Y. EXEC. LAWS §§ 173-a(3), 173(2) (2014) (requiring that CCVs provide the charity with a final accounting within ninety days after the conclusion of the charitable sales promotion); N.C. GEN. STAT. ANN. § 131F-18(c) (2014); OHIO REV. STAT. ANN. § 1716.09(c) (2014); OR. REV. STAT. § 128.848 (2014); S.C. CODE ANN. § 33-56-70(E) (2014); TENN. CODE ANN. § 48-101-519(c) (2014); UT. CODE ANN. § 13-22-22(3) (2014); VA. CODE ANN. § 57-61.2(C) (2014).

75. ALA. CODE ANN. § 13A-9-71(i) (2014); ARK. CODE ANN. § 4-28-408(a)(1) (2014); Cal. Gov't Code § 12599.2(c) (2014) (requiring a contract only for unregistered CCVs); CT. GEN. STAT. ANN. § 21a-190g(a) (2014); FLA. STAT. ANN. § 496.414(1) (2014); GA. CODE ANN. § 43-17-6(a) (2014); HAW. REV. STAT. § 467B-5.5(b) (2014); LA. REV. STAT. 51:1901.2(A) (2014); N.H. REV. STAT. § 7:28-d(II) (2014); N.J. STAT. ANN. § 45:17A-29(a) (2014); N.Y. EXEC. LAWS § 173-a(1) (2014); N.C. GEN. STAT. ANN. § 131F-18(a) (2014); OHIO REV. STAT. ANN. § 1716.09(A) (2014); OR. REV. STAT. § 128.856 (2014); S.C. CODE ANN. § 33-56-70(A) (2014); TENN. CODE ANN. § 48-101-519(b) (2014); UT. CODE ANN. § 13-22-22(2) (2014); VA. CODE ANN. § 57-61.2(B) (2014).

76. Alabama, Arkansas, Hawaii, New Jersey, and New York require that the commercial co-venturer contract be filed with the Attorney General. ALA. CODE ANN. § 13A-9-71(i) (2014); ARK. CODE ANN. § 4-28-408(a)(1) (2014); HAW. REV. STAT. § 467B-5.5(c) (2014); N.J. STAT. ANN. § 45:17A-29(a) (2014) (P.L.1994, c.16, requiring a \$30 contract filing fee); N.Y. EXEC. LAWS §§ 173-a(1-4) (2014). Connecticut requires the commercial co-venturer contract be filed with the Department of Consumer Protection. CT. GEN. STAT. ANN. § 21a-190g(a) (2014). South Carolina requires the commercial co-venturer contract be filed with the Secretary of State, in conjunction with a completed Notice of Solicitation Form. S.C. CODE ANN. § 33-56-70(A) (2014).

77. ALA. CODE ANN. § 13A-9-71(h)(1) (2014); MASS. STAT. ch. 68, § 24(b) (2014).

Attempts to standardize the regulation of CCVs, much like the URS' attempt to unify charitable registration requirements, have proven unsuccessful. In 1999, the attorneys general of sixteen states published *A Preliminary Multistate Report on Nonprofit Product Marketing* to clarify the legal obligations of participants in commercial co-venture partnerships.<sup>78</sup> The *Multistate Report* also proposed guidelines for regulating charitable sales promotions, which included the following key principles: (1) avoiding misrepresentations regarding the endorsement of products by a charitable organization;<sup>79</sup> (2) avoiding claims that a product is superior to other products, unless that claim is substantiated and determined by the charity;<sup>80</sup> (3) indicating that the CCV has paid for the use of the charitable organization's name or logo;<sup>81</sup> (4) avoiding misleading or deceptive representations regarding the effect of a consumer's purchase on charitable contributions by the CCV;<sup>82</sup> and (5) avoiding exclusive product sponsorships.<sup>83</sup> While these guidelines provide insight into practices that may raise the eyebrows of some state charity regulators, they have not been formally adopted by any state and do not have the force of law.<sup>84</sup> As a result, CCVs and the charitable organizations with which they partner are left to navigate the complex waters of co-venture regulations on a state-by-state basis.

As this Part has shown, the regulation of charitable solicitation has grown considerably since its introduction over seventy years ago. Despite efforts to standardize these regulations, state lawmakers have taken a range of different approaches to this regulatory regime. The resulting irregularities in registration and reporting requirements leave charities and their commercial partners with a regulatory landscape that requires constant diligence, and disproportionately disadvantages smaller, less sophisticated organizations. With this in mind, this Article

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78. *What's in a Nonprofit's Name? Public Trust, Profit and the Potential for Public Deception: A Preliminary Multistate Report on Nonprofit Product Marketing* (April 1999) [hereinafter *The Multistate Report*], available at [http://ago.vermont.gov/assets/files/Whats%20in%20a%20Name\\_report-nonprofit\\_mkting.pdf](http://ago.vermont.gov/assets/files/Whats%20in%20a%20Name_report-nonprofit_mkting.pdf); see also Chansky, *supra* note 66.

79. *The Multistate Report*, *supra* note 78, at 24–26.

80. *Id.* at 26–27.

81. *Id.* at 28–29.

82. *Id.* at 29–30.

83. *Id.* at 30–33.

84. *Id.* at 8.

turns to confront the question of whether charitable solicitation acts should apply to newly authorized social enterprise forms.

## II.

### CHARITABLE SOLICITATION ACTS AS APPLIED TO SOCIAL ENTERPRISE FORMS

Social enterprise forms break with the traditional corporate law dichotomy of nonprofit organizations, whose primary purpose is charitable, and for-profit corporations, whose primary purpose is the maximization of shareholder wealth.<sup>85</sup> Social enterprise embraces a more complex and multifaceted view of corporate purpose, and requires adopters of these new corporate forms to consider social and environmental purposes alongside financial returns. This Part begins by highlighting the surprisingly broad spectrum of purposes permitted by social enterprise enabling statutes, and suggests that these organizations can be separated into two categories: charitable purpose social enterprises, and non-charitable purpose social enterprises.

One of the consequences of these innovative legal structures is regulatory uncertainty. Corporate regulatory regimes were designed to oversee the operations and activities of either for-profit organizations or nonprofit organizations, but neither is equipped to enforce the blended-value goals of social enterprise. Like all other for-profit corporations, social enterprises are subject to the corporate codes of the states in which they are organized.<sup>86</sup> If, for example, a benefit corporation wished to trade its securities on a public exchange, it would be subject to the same state and federal securities laws and regulations as any other publicly-traded company.<sup>87</sup> How-

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85. Kyle Westaway, *Beyond Black and White: The New Paradigm of Social Enterprise*, 9 N.Y.U. J.L. & BUS. 439 (2013).

86. See, e.g., R.I. GEN. LAWS ANN. § 7-5.3-1(c) (West 2014) (“Except as otherwise provided in this chapter, all provisions of the general corporation law, including the Rhode Island Business Corporation Act, chapter 1.2 of this title, applicable to domestic business corporations are applicable to corporations organized under this chapter. A benefit corporation may be subject simultaneously to this chapter and chapters 5.1 of this title.”).

87. Currently, there are no benefit corporations or other social enterprise forms that are publicly-traded. However, there are benefit corporations that operate as wholly-owned subsidiaries of publicly-traded parent corpora-

ever, the for-profit regulatory regime revolves around the fiduciary duties and disclosure requirements regarding the financial aspects of the business, and does little to ensure that these organizations remain committed to their social or environmental purposes.<sup>88</sup>

On the other hand, charity regulators are accustomed to ensuring nonprofit organizations abide by their stated charitable purpose. Casual observers might assume that the social and environmental purposes of social enterprise forms are coextensive with the charitable purposes of nonprofit organizations, and therefore charity regulators may also claim jurisdiction over social enterprises. However, this Part argues that the efforts to impose nonprofit regulatory regimes on social enterprise forms are misplaced, and reflect a misunderstanding of the innovative nature of these for-profit corporate forms. Proponents of imposing charitable solicitation regulations on social enterprise fail to draw an important distinction between *charitable* purposes and *social* or *environmental* purposes, and neglect to consider the means by which these purposes are achieved.<sup>89</sup>

This Part examines the legal basis for the proposition that social enterprises fall under the purview of charitable solicitation regulation by asking three fundamental questions: (1) are

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tions. For example, in June 2013, Campbell Soup Company (NYSE:CPB) completed its acquisition of Plum Organics, PBC a Delaware public benefit corporation. *Campbell's Completes Acquisition of Plum Organics*, CAMPBELL SOUP CO., <http://investor.campbellsoupcompany.com/phoenix.zhtml?c=88650&p=irol-newsArticle&ID=1829771&highlight=> (last updated June 13, 2013).

88. See, e.g., *Commission Guidance Regarding Disclosure Related to Climate Change*, Release Nos. 33-9106, 34-61469, 75 Fed. Reg. 6290 (Feb. 8, 2010) (recommending climate change-related disclosure, but emphasizing that the Guidance did not institute new, nor modify existing disclosure requirements).

89. See Robert T. Esposito & Shawn Pelsinger, *People, Planet, Profit ... Religion? How Legal Challenges to the Contraceptive Mandate Implicate Social Enterprise*, STAN. SOC. INNOVATION REV. (Jan. 23, 2014), [http://www.ssireview.org/blog/entry/people\\_planet\\_profit...religion](http://www.ssireview.org/blog/entry/people_planet_profit...religion) (discussing the distinction between three types of corporate purpose: (1) profit; (2) social/environmental; and (3) religious); David Edward Spenard, *The Cycle of Innovation and Regulation: The Development of a State Charity Regulatory Dialectic for Charitable Investment in Social Enterprise Activity Through a Limited Liability Company Structure*, 9 N.Y.U. J.L. & BUS. 603 (2013) (emphasizing the importance of the distinction between “charitable” and “social/environmental” purposes for regulating L3Cs).

social enterprise “charitable organizations”; (2) are social enterprises engaged in the “solicitation” of charitable funds; and (3) are social enterprises “commercial co-venturers”?

A. *Are Social Enterprises Charitable Organizations?*

Charitable solicitation acts were written when the line between charitable and for-profit organizations was relatively easy to draw. The emergence of social enterprise forms, however, has muddied the waters considerably. Social enterprises are unique among corporate forms because they are required by law to articulate social or environmental purposes, in addition to the traditional purpose of maximizing shareholder wealth. These additional corporate purposes sometimes include “charitable” purposes<sup>90</sup> that nonprofit organizations traditionally carry out, which raises the question: are social enterprises “charitable organizations” as contemplated by state charitable solicitation acts? Matters are complicated by the fact that case law generally does not explore the scope of the term “charitable” in the context of these acts,<sup>91</sup> and in the absence of judicial guidance, charity regulators adopt a broad interpretation of their jurisdiction.<sup>92</sup>

The first step in this analysis is to determine what additional purposes social enterprise forms are permitted to pursue. An L3C must be organized for a charitable or educational

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90. HOPKINS, *supra* note 40, at 18–19 (“The term *charitable* in the federal income tax setting embraces a variety of purposes and activities. These include the relief of the poor and distressed or of the underprivileged, [citing 26 C.F.R. § 1.501(c)(3)-1(d)(2)], the advancement of religion [*id.*], the advancement of education or science [*id.*], lessening of the burdens of government [*id.*], community beautification and maintenance [citing 78-85, 1978-1 C.B. 150], promotion of health [citing 69-545, 1959-2 C.B. 117], promotion of social welfare [citing 26 C.F.R. § 1.501(c)(3)-1(d)(2)], promotion of environmental conservancy [citing Rev. Rul. 76-204, 1976-1 C.B. 152], advancement of patriotism [citing Rev. Rule 78-84, 1978-1 C.B. 150], care of orphans [citing Rev. Rul. 80-200, 1980-2 C.B. 173], maintenance of public confidence in the legal system [citing Kentucky Bar Foundation, Inc. v. Commissioner, 78 T.C. 921 (1982)], facilitating student and cultural exchanges [citing Rev. Rul. 80-286, 1980-2 C.B. 179], and promotion and advancement of amateur sports [citing Hutchinson Baseball Enterprises, Inc. v. Commissioner, 73 T.C. 144 (1979), *aff’d* 696 F.2d 757 (10th Cir. 1982)].”).

91. *Id.* at 50 (citing Commonwealth v. Ass’n of Community Orgs. for Reform Now (ACORN), 463 A.2d 406 (Pa. 1983); Packel v. Frantz Advertising, Inc. 353 A.2d 492 (Pa. 1976)).

92. *Id.*

purpose.<sup>93</sup> A benefit corporation must be organized for the purpose of creating a “general public benefit,” and has the option to adopt one or more “specific public benefits.”<sup>94</sup> A “general public benefit” is defined as a “material positive impact on society and the environment, taken as a whole, assessed against a third-party standard, from the business and operations of a benefit corporation.”<sup>95</sup> Most benefit corporation statutes enumerate a list of optional specific public benefits, as follows:

- (1) providing low-income or underserved individuals or communities with beneficial products or services;
- (2) promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business;
- (3) protecting or restoring the environment;
- (4) improving human health;
- (5) promoting the arts, sciences, or advancement of knowledge;
- (6) increasing the flow of capital to entities with a purpose to benefit society or the environment; and
- (7) conferring any other particular benefit on society or the environment.<sup>96</sup>

The corporate purpose language of social purpose corporation (SPC) statutes varies, but with the exception of California, they generally require an SPC to be organized to promote positive, or minimize negative effects of the corporation’s activities on society and the environment.<sup>97</sup> In addition

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93. *See, e.g.*, VT. STAT. ANN. tit. 11, § 3001(27)(A) (West, Westlaw through First Sess. 2013–2014 General Assemb.).

94. MODEL BENEFIT CORP. ACT § 201 (2013). Delaware, which passed its own version of benefit corporation legislation, uses different language to describe corporate purpose: “[a public benefit corporation is] intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner.” DEL. CODE ANN. tit. 8, § 362(a) (West, Westlaw through 2014).

95. MODEL BENEFIT CORP. ACT § 102 (2013).

96. *Id.*

97. *See, e.g.*, WASH. REV. CODE ANN. § 23B.25.020 (West 2014, Westlaw through 2014 Reg. Sess.) (“Every [SPC] must be organized to carry out its business purpose under RCW 23B.03.010 in a manner intended to promote positive short-term or long-term effects of, or minimize adverse short-term or long-term effects of, the corporation’s activities upon any or all of (1) the

to the this general social purpose,<sup>98</sup> California's SPC statute stands alone as the only one of its kind to permit an SPC to be organized for "one or more charitable purpose activities that a nonprofit public benefit corporation is authorized to carry out."<sup>99</sup> In Washington, SPCs, like benefit corporations, also have the option to designate one or more specific social purposes that the organization has elected to pursue.<sup>100</sup>

In reviewing these provisions, it is readily apparent that social enterprise forms offer a surprisingly broad array of purposes. Indeed, these purposes range from the strictly charitable, in the case of the L3C, to the social or environmental produced as a byproduct of an organization's profit-making endeavors, in the case of the benefit corporation. For the purposes of this analysis, then, it is helpful to divide these organizations into two categories: (1) charitable purpose social enterprises; and (2) non-charitable purpose social enterprises.

### 1. *Charitable Purpose Social Enterprises*

Two social enterprise forms fall into the category of charitable social enterprises: the L3C and the California SPC. An L3C is legally obligated to pursue a charitable or educational purpose that tax-exempt organizations carry out. In fact, enabling statutes adopt a "but for" test to ensure that L3Cs "would

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corporation's employees, suppliers, or customers; (2) the local, state, national, or world community; or (3) the environment"); TX. BUS. ORG. CODE § 1.002(82-a) (defining "social purposes" as those which "consist of promoting one or more positive impacts on society or the environment or of minimizing one or more adverse impacts of the corporation's activities on society or the environment"); FLA. REV. STAT. §§ 607.506, 607.502(6) (declaring that an SPC "has the purpose of creating a public benefit," and defining "public benefit" as "a positive effect, or the minimization of negative effects, taken as a whole, on the environment or on one or more categories of persons or entities, other than shareholders in their capacity as shareholders, of an artistic, charitable, economic, educational, cultural, literary, religious, social, ecological, or scientific nature, from the business and operations of a social purpose corporation").

98. CAL. CORP. CODE §§ 2602(b)(2)(B)(i)–(iii) (West, Westlaw through 2014 Reg. Sess.).

99. *Id.* § 2602(b)(2)(A).

100. WASH. REV. CODE ANN. § 23B.25.030 (West 2014, Westlaw through 2014 Reg. Sess.). The Florida and Texas statutes contain a list of examples of "social purposes" that mirrors the Model Benefit Corporation's list of "specific public benefits." FLA. REV. STAT. §§ 607.602(a)–(f); TX. BUS. ORG. CODE §§ 1.002(82-a)(A)–(G); MODEL BENEFIT CORP. ACT § 102 (2013).

not have been formed *but for* the company's relationship to the accomplishment of charitable or educational purposes."<sup>101</sup> The California SPC form is more problematic, because the enabling statute creates two distinct types of SPCs. In California, an SPC may be organized either (1) for one or more charitable or public purposes that nonprofit organizations carry out (Type I); or (2) for the promotion of positive effects, or minimization of negative effects, on employees, suppliers, customers, creditors, the community and society, or the environment (Type II).<sup>102</sup> The distinction between the charitable purpose of a Type I SPC and the social or environmental purposes of a Type II SPC is important and discussed further below. For now, it is enough to say that the L3C and Type I SPC, like all public charities, are required by law to be established for a charitable purpose. Unlike public charities, however, the L3C and Type I SPC are for-profit corporate forms.

But how can a for-profit corporation, even one with a stated charitable purpose, be classified as a "charitable" organization? The answer to this question lies in the surprisingly broad definition of the term "charitable organization" in state charitable solicitation acts, which often encompass much more than tax-exempt 501(c)(3) organizations.<sup>103</sup> The 1986 Model Act identifies two categories of charitable organizations, and because the Model Act's definition has been adopted in a majority of jurisdictions, it is instructive here. Under the 1986 Model Act, charitable organizations encompass both: "(1) those that are tax-exempt 501(c)(3) organizations; and (2) [a]ny person who is or holds himself out to be established for any benevolent, educational, philanthropic, humane, scientific, patriotic, social welfare or advocacy, public health, environmental conservation, civic or other eleemosynary purpose . . . ."<sup>104</sup>

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101. VT. STAT. ANN. tit. 11, § 3001(27)(A)(2) (West, Westlaw through First Sess., 2013–2014 General Assemb.) (emphasis added). If, at any time, an L3C fails to pursue its stated charitable or educational purpose, it automatically reverts to a traditional LLC form. Reiser, *supra* note 11, at 233.

102. CAL. CORP. CODE § 2602(b)(2).

103. HOPKINS, *supra* note 40, at 18 ("The term *charitable* organization as used in the state charitable solicitation acts has a meaning considerably broader than that traditionally employed under state law and under the federal tax law.")

104. 1986 MODEL ACT, *supra* note 36, § 1(a)(2).

Importantly, the scope of the first category is circumscribed by an organization's federal tax status, while the second category depends entirely on an organization's stated purpose, *irrespective* of tax status or an organization's ability to disburse profits to shareholders. Combined, these two categories cast a remarkably wide net.

Because social enterprise forms are not tax-exempt,<sup>105</sup> they do not fall into the first category. However, the L3C and Type I SPC are charitable social enterprises whose purpose is required by law to correspond with those that nonprofit organizations carry out. Thus, the fact that they are for-profit, profit-distributing organizations is irrelevant in the context of defining "charitable organizations" under charitable solicitation acts. It is enough to say that these forms are established for charitable purposes, and this fact alone classifies them as "charitable organizations" in many states.

## 2. *Non-Charitable Social Enterprises*

In contrast, other social enterprise forms are not beholden to a charitable purpose. Consider a Type II SPC that is dedicated to minimizing negative effects on the environment. To achieve this purpose, its directors decide to power all corporate offices with renewable energy sources, initiate a carbon offset program for all company travel, select suppliers that abide by rigorous environmental and workplace standards, and commit to exclusively producing sustainable products and services. The directors of this hypothetical Type II SPC have made these choices to align the organization's business operations with its environmental purpose.<sup>106</sup> But these decisions do not magically convert this hypothetical Type II SPC into a charitable organization, even under the 1986 Model Act's

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105. Apart from a handful of municipal tax credits, social enterprise forms offer no tax-favorable treatment. *See, e.g., Credits, Grants & Other Incentives*, CITY OF PHILA. BUS. SERVS., <https://business.phila.gov/pages/taxcredit-sotherincentives.aspx> (last visited Sept. 25, 2014) (offering a \$4,000 tax credit per year to certified B Corporations that are located within the Philadelphia city limits). However, some scholars have suggested that social enterprise forms are deserving of favorable tax treatment at the federal level. *See* Lloyd Hitoshi Mayer & Joseph R. Ganahl, *Taxing Social Enterprise*, 66 STAN. L. REV. 387 (2014); Joseph M. Binder, *Note: A Tax Analysis of the Emerging Class of Hybrid Entities*, 78 BROOK. L. REV. 625 (2013).

106. Spenard, *supra* note 89, at 608.

sweeping definition. SPC enabling statutes make clear that an SPC achieves its social purpose by “carry[ing] out its *business* purpose”<sup>107</sup> so as to promote positive, or minimize negative, effects of “the corporation’s activities”<sup>108</sup> upon non-shareholder groups. In other words, the social purpose of an SPC—in this case, the minimization of negative effects on the environment—is the byproduct of its business enterprise. More importantly, the crucial distinction here is that Type II SPCs may select purposes, such as the minimization of negative environmental effects, that, while laudable and desirable, are not explicitly “charitable” purposes in the eyes of the law.

Another example of a non-charitable social enterprise is the benefit corporation, which is required to pursue a “general public benefit.” This is a term of art specific to benefit corporation legislation, defined as a “material positive impact on society and environment, taken as a whole,” determined by an independent, third-party standard against which a benefit corporation measures its social and environmental performance. Importantly, the general public benefit is produced “*from the business and operations* of a benefit corporation.”<sup>109</sup> In other words, the general public benefit is a byproduct of a benefit corporation’s business operations, not vice versa. For example, Blessed Coffee, a Maryland corporation, was the second organization to register as a benefit corporation in the United States.<sup>110</sup> It sources coffee beans directly from Ethiopian coffee cooperatives, thereby allowing it to bring Ethiopian coffee to new markets and simultaneously provide higher profit margins to the coffee growers.<sup>111</sup> The social and economic benefits to coffee growers in a developing country are embedded in Blessed Coffee’s business model. However, Blessed Coffee is primarily engaged in the business of selling coffee; its pursuit of a general public benefit is a byproduct of, and proportional to, the success of its profit-making enterprise. Like the Type II SPC hypothetical discussed above, this example shows that a

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107. WASH. REV. CODE ANN. § 23B.25.020 (West, Westlaw through 2014 Reg. Sess.) (emphasis added).

108. *Id.*; see also TX. BUS. ORG. CODE § 1.002(82-a); FLA. REV. STAT. § 607.502(6).

109. MODEL BENEFIT CORP. ACT § 102 (2013) (emphasis added).

110. *The Nation’s Second Benefit Corporation*, BLESSED COFFEE, <http://blessedcoffee.us/benefit-corp.html> (last visited Sept. 25, 2014).

111. *Id.*

benefit corporation's dedication to a "general public benefit" is not coterminous with a charitable purpose.<sup>112</sup>

In sum, a close analysis of the scope of the term "charitable organization" in state charitable solicitation acts reveals that it is so broad as to encompass charitable purpose social enterprise forms; namely, the L3C and the California Type I SPC. Non-charitable social enterprises, on the other hand, offer social entrepreneurs a variety of social or environmental purposes. Importantly, these purposes are not necessarily equivalent to "charitable" purposes as contemplated by charitable solicitation acts. Rather, non-charitable social enterprises are, and hold themselves out to be, businesses that are dedicated to serving a social or environmental purpose, but this is crucially distinct from an organization declaring to the public that it is established for a charitable purpose. Nevertheless, given the current regulatory climate, attorneys counseling clients who wish to adopt social enterprise forms for their business ventures should carefully draft corporate purpose provisions with these distinctions in mind.

B. *Are Social Enterprises Engaged in the Solicitation of Charitable Funds?*

Being classified as a "charitable organization," in and of itself, is not enough to trigger the regulatory requirements imposed by charitable solicitation acts. Charitable organizations must satisfy an additional element—the actual solicitation of charitable contributions—in order to fall under the charitable solicitation regulatory regime. Thus, for organizations that are required by law to pursue a charitable purpose, the analysis turns to how these organizations raise funds. The 1986 Model Act defines "solicitation" as follows:

the request directly or indirectly for money, credit, property, financial assistance, or other thing of any kind or value on the plea or representation that such money, credit, property, financial assistance, or other

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112. As Assistant Attorney General for Kentucky, David Edward Spenard, observes: "If investors of a for-profit corporation want to band together with the intent to authorize the directors of the for-profit corporation (the agents of the investors) to consider goals other than the maximization of investors' financial wealth, then so be it. It is their money." Spenard, *supra* note 89, at 607.

thing of any kind or value, or any portion thereof, will be used for a charitable purpose or benefit a charitable organization.<sup>113</sup>

This definition, which is quite broad, has been widely adopted by the states.<sup>114</sup> Despite its breadth, a fundamental element of a “solicitation” is omitted by this definition; namely, that a solicitation necessarily involves seeking a charitable contribution or gift.<sup>115</sup> However, the inherent connection between the act of soliciting and the object of the solicitation is made clear when one reads the definition of “solicitation” *in pari materia* with the 1986 Model Act’s definition of “contribution,” to wit: “the grant, promise or pledge of money, credit, property, financial assistance or other thing of any kind or value *in response to a solicitation*.”<sup>116</sup> This definition closes the regulatory loop of charitable solicitation acts—solicitations seek charitable contributions, and contributions respond to solicitations. Indeed, the innate connection between solicitations and charitable gifts is a fundamental underpinning of nonprofit regulation, and circumscribes the jurisdictional reach of charitable solicitation acts.

However, in defining the terms “solicitation” and “contribution” in reference to one another, the 1986 Model Act omits another fundamental element of charitable giving, namely, the absence of consideration. The term “gift,” though not defined in the acts, is generally defined as “the voluntary transfer of property to another without compensation,”<sup>117</sup> and is often used interchangeably with the term “donation,” which is defined as “a transfer of money or property in the absence of consideration.”<sup>118</sup> The Supreme Court and the IRS have both

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113. 1986 MODEL ACT, *supra* note 36, § 1(c).

114. HOPKINS, *supra* note 40, at 50.

115. *Id.* at 51 (citing *State v. Blakney*, 361 N.E.2d 567, 568 (Ohio 1975) (holding that the state’s charitable solicitation act did not apply to gambling activities held to generate funds for charitable purposes); *Brown v. Marine Club, Inc.*, 365 N.E.2d 1277 (Ohio 1976)). In general, the terms “contribution” and “gift” are synonymous and are used interchangeably. See I.R.C. § 170(c) (defining “charitable contribution” as a “contribution or gift to or for the use of” a permissible donee); *Channing v. United States*, 4 F. Supp. 33, 34 (D. Mass. 1933), *aff’d per curiam*, 67 F.2d 986 (1st Cir. 1933), *cert. denied*, 291 U.S. 686 (1934); *Sutton v. Commissioner*, 57 T.C. 239 (1971).

116. 1986 MODEL ACT, *supra* note 36, § 1(e) (emphasis added).

117. BLACK’S LAW DICTIONARY 757 (9th ed. 2009).

118. HOPKINS, *supra* note 40, at 52.

emphasized the concept of consideration in formulating a test to determine the deductibility of charitable contributions. In the seminal case of *United States v. American Bar Endowment*, the Supreme Court cited with approval Rev. Rul. 67-246 in observing that the “*sine qua non* of a charitable contribution is a transfer of money or property without adequate consideration.”<sup>119</sup> In other words, the act of soliciting necessarily implies that the solicitor is requesting a charitable gift or donation for which the donor expects nothing of material value in return.<sup>120</sup>

In contrast, entrepreneurs who adopt for-profit social enterprise forms make a conscious decision to fund their ventures with investment capital, not donations.<sup>121</sup> These investors, unlike donors, *do* expect something of material value—a return on their investment. This distinction holds true for both charitable and non-charitable social enterprises.

### 1. *Charitable Purpose Social Enterprises*

Charitable purpose social enterprises, most notably the L3C form, are designed to raise capital through program-related investments (PRIs) from private foundations.<sup>122</sup> In general, tax law prohibits private foundations from making “jeopardizing,” or risky, investments.<sup>123</sup> However, an exception to this general prohibition is available for PRIs.<sup>124</sup> In order to

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119. 477 U.S. 105, 117–18 (1986). *Accord* *Consol. Investors Group v. Commission*, T.C. Memo 2010-158. This test, formulated under Rev. Rul. 67-246 and approved by the Supreme Court in *American Bar Endowment*, was later incorporated in Treas. Reg. § 1.170A-1(h)(1).

120. HOPKINS, *supra* note 40, at 51.

121. The author acknowledges that some of these organizations, particularly in their early stages of development, may receive grants from private foundations in lieu of or in addition to investment capital. *See generally* *Impact Deals*, IMPACTSPACE, <http://impactspace.com/investments> (last visited Feb. 12, 2015). Grants, however, are private dollars not subject to charitable solicitation acts whose reach are limited to the solicitation of charitable funds from the public, and are often made to catalyze private investment, not charitable donations.

122. For a more comprehensive explanation of L3Cs and PRI, see Esposito, *supra* note 2; *see also* Cassady V. Brewer, *A Novel Approach to Using LLCs for Quasi-Charitable Endeavors (a/k/a Social Enterprise)*, 38 WM. MITCHELL L. REV. 678, 711–15 (2012). California’s Type I SPC, while lacking the formal transcription of PRI requirements, is nevertheless a “charitable purpose social enterprise” that can arguably receive PRIs from private foundations.

123. I.R.C. §§ 4944(a)–(b) (2006).

124. *Id.* § 4944(c).

qualify for this exception, a private foundation's investment must (1) have the primary purpose of accomplishing a tax-exempt purpose,<sup>125</sup> (2) not have as a significant purpose the production of income or the appreciation of property,<sup>126</sup> and (3) not have the purpose of influencing legislation or participating in political campaigns.<sup>127</sup> These same requirements are found in L3C enabling statutes,<sup>128</sup> a drafting technique intended to ensure that foundation investments in L3Cs receive PRI status.<sup>129</sup>

By carving out this exception, Congress permitted private foundations to pursue their exempt purposes by making investments, as opposed to the traditional approach of providing grants to public charities.<sup>130</sup> In April 2012, the IRS attempted to clarify the scope of PRI criteria by issuing proposed regulations “to illustrate that a wider range of investments qualify as PRIs than the range currently presented in § 53.4944-3(b) . . . .”<sup>131</sup>

Despite recent attempts at regulatory clarity, PRIs remain rare, and account for less than one-percent of the \$90 billion private foundations distribute each year.<sup>132</sup> Private founda-

125. *See id.* (stating that one of the requirements is having, as a primary purpose, “to accomplish one or more of the purposes described in section 170(c)(2)(B)” of the Internal Revenue Code, which describes various tax-exempt purposes).

126. *Id.*

127. Treas. Reg. § 53.4944-3(a)(1)(iii) (referencing the forbidden behavior of lobbying/political campaigns cited in I.R.C. (170(c)(2)(D)).

128. *See, e.g.,* VT. STAT. ANN. tit 11, §§ 3001(27)(A)–(C) (West 2014).

129. Unfortunately for L3C proponents, this technique is dependent upon corresponding federal legislation amending the PRI provisions of the I.R.C., which has not yet occurred. *See* Daniel S. Kleinberger, *A Myth Deconstructed: The “Emperor’s New Clothes” on the Low-Profit Limited Liability Company*, 34 DEL. J. CORP. L. 879, 908 (2010).

130. Brewer, *supra* note 122, at 712; *see also, e.g.,* I.R.S. Priv. Ltr. Rul. 200034037 (May 31, 2000) (holding that below-market loans to foreign media entities are PRIs); I.R.S. Priv. Ltr. Rul. 199943044 (July 26, 1999) (ruling that a private foundation may own a for-profit entity’s stock as a PRI).

131. Prop. Treas. Reg. § 53.4944, 77 Fed. Reg. 23,429 (Apr. 19, 2012); *see also* Esposito, *supra* note 2, at 686–87. Recently, the IRS announced its plans to finalize the proposed PRI regulations. *2014-2015 Priority Guidance Plan*, DEPT. OF TREAS., available at [http://www.irs.gov/pub/irs-utl/2014-2015\\_pgp\\_1st\\_quarter\\_update.pdf](http://www.irs.gov/pub/irs-utl/2014-2015_pgp_1st_quarter_update.pdf).

132. *See* Steven Lawrence, *Doing Good with Foundation Assets: An Updated Look at Program-Related Investments*, in *THE PRI DIRECTORY: PROGRAM RELATED INVESTMENTS AND LOANS BY FOUNDATIONS* xiii (Jeffrey A. Falkenstein & David

tions are reluctant to engage in PRIs for several legitimate reasons, such as the cost of obtaining a private letter ruling from the IRS or a legal opinion letter from a tax attorney,<sup>133</sup> the ongoing diligence required to fulfill “expenditure responsibility” over such investments,<sup>134</sup> or the risk of severe excise taxes if the IRS rejects the PRI status of an investment.<sup>135</sup> Moreover, L3C legislation was enacted at the state level without corresponding federal legislation to amend the Internal Revenue Code provisions governing PRIs. Several commentators have concluded that, in the absence of federal legislation, the L3C form does not live up to its promise of being a reliable PRI receiver, and “does nothing to help foundations seeking to assure themselves of PRI treatment.”<sup>136</sup>

Nevertheless, the L3C and Type I SPC forms remain available, and these forms may be useful for social entrepreneurs that have cultivated relationships with private foundations with the means to manage PRIs. Consider a successful example in which a charitable purpose social enterprise obtains a PRI in the form of a low-interest loan from a private foundation—has it solicited charitable funds? Here, the distinction between charitable contributions and investments plays an important role. As the term “PRI” suggests, private foundations *invest* their money, and like all other investors, they expect a return on their investment.<sup>137</sup> Accordingly, because PRIs are made

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G. Jacobs eds., 3d ed. 2010); *see also* Brewer, *supra* note 122, at 712; *cf. How We Work—Program Related Investments*, BILL & MELINDA GATES FOUND., <http://www.gatesfoundation.org/How-We-Work/Quick-Links/Program-Related-Investments> (The Gates Foundation has operated a PRI fund that manages \$1.5 billion in assets); *RSF Launches Food & Agriculture PRI Fund*, RSF SOCIAL FINANCE (July 2, 2010) <http://rsfsocialfinance.org/2010/07/food-ag-pri-launch/> (discussing how RSF Capital Management launched a food and agriculture PRI fund in July 2010).

133. James P. Joseph & Andras Kosaras, *New Strategies for Leveraging Foundation Assets*, TAX’N EXEMPTS, July–Aug. 2008, at 22; *see also* Esposito, *supra* note 2; Brewer, *supra* note 115, at 715.

134. Brewer, *supra* note 122, at 712 (explaining that many foundations are reluctant to shoulder the due diligence, monitoring, and reporting requirements imposed by their “expenditure responsibility” over such investments).

135. *Id.* at 712–13.

136. Kleinberger, *supra*, note 129, at 908; *see also* Manny, *supra* note 22.

137. Because PRIs must “not have as a significant purpose the production of income or the appreciation of property,” they often take the form of below-market rate loans. *See Program-Related Investments*, IRS, <http://www.irs.gov/Charities-&-Non-Profits/Private-Foundations/Program-Related-Invest>

for consideration, with the expectation of a return, the hypothetical charitable purpose social enterprise has not solicited charitable funds; rather, it has successfully obtained an investment.

## 2. *Non-Charitable Social Enterprises*

Unlike charitable purpose social enterprise forms, the benefit corporation and most SPCs are not designed to receive investments from private foundations. Rather, non-charitable social enterprise forms are designed to compete with traditional for-profit corporations and raise funds with equity capital.<sup>138</sup> Recent examples illustrate how these organizations, especially the benefit corporation form, are proving the blended-value concept of these legal structures.<sup>139</sup>

Global Uprising PBC, doing business as Cotopaxi,<sup>140</sup> is a Delaware public benefit corporation based in Cottonwood Heights, Utah. Cotopaxi is an outdoor gear and apparel company that is dedicated to producing a general public benefit.<sup>141</sup> The company achieves this mission by tying each purchase to a humanitarian cause in the developing world through donations to partner organizations.<sup>142</sup> For example, the purchase of a water bottle gives six months' worth of clean

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ments (citing the following as examples of PRIs: "1. Low-interest or interest-free loans to needy students, 2. High-risk investments in nonprofit low-income housing projects, 3. Low-interest loans to small businesses owned by members of economically disadvantaged groups, where commercial funds at reasonable interest rates are not readily available, 4. Investments in businesses in deteriorated urban areas under a plan to improve the economy of the area by providing employment or training for unemployed residents, and 5. Investments in nonprofit organizations combating community deterioration"). However, higher interest rates are not dispositive as to whether a particular investment qualifies as a PRI. The IRS has ruled that a PRI to an LLC taking the form of a loan with a 15% interest rate did not disqualify it from receiving PRI status. See Brewer, *supra* note 122, at 713.

138. Dana Brakman Reiser & Steven A. Dean, *Hunting a Stag with FLY Paper: A Hybrid Financial Instrument for Social Enterprise*, 54 B.C. L. REV. 1495, 1507 (2013).

139. For a database of nearly 2,000 examples, see IMPACTSPACE, *supra* note 121.

140. *Gear for Good: A Quick Overview of How and Why We're Different*, COTOPAXI, <http://cotopaxi.com/pages/gear-for-good> (last visited Feb. 12, 2015).

141. *Id.*

142. *Id.*

drinking water to an individual in India.<sup>143</sup> In July 2014, the company completed a \$3 million round of fundraising from several investment firms and individual investors.<sup>144</sup>

Another Delaware public benefit corporation, Ello, PBC, also recently raised seed stage capital.<sup>145</sup> Ello is an advertising-free social network that experienced exponential growth as users of other social networks became increasingly concerned about their online privacy and targeted advertising.<sup>146</sup> In contrast to its competitors, Ello incorporated as a public benefit corporation and included several provisions in its charter which prohibit it from selling user-specific data to third parties or entering into agreements to display paid advertising on behalf of third parties on its social network.<sup>147</sup> The mission, according to CEO and co-founder Paul Budnitz, is to “create an ad-free space in the digital world where people aren’t the product.”<sup>148</sup> In October 2014, just two months after it launched, Ello announced that it had completed a \$5.5 million round co-led by Foundry Group and Techstars’ Bullet Time Ventures.<sup>149</sup>

Early stage funding has not been limited to benefit corporations. According to co-founder Mark Horoszowski, MovingWorlds SPC recently became the first social purpose corporation to raise a seed round of financing.<sup>150</sup> MovingWorlds, a Washington SPC based in Seattle, aims to accelerate social impact through an online platform that con-

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143. *Stainless Steel Insulated Water Bottle—India 20 oz—Cotopaxi—Gear for Good*, COTOPAXI, <http://cotopaxi.com/collections/gear/products/water-bottle-india> (last visited Nov. 19, 2014).

144. Lizette Chapman, *Cotopaxi Raises \$3M for Do-Good Outdoor Company*, WALL ST. J. (July 22, 2014, 11:00 AM), <http://blogs.wsj.com/venturecapital/2014/07/22/cotopaxi-raises-3m-for-do-good-outdoor-company/>.

145. Lizette Chapman, *Ello Raises \$5.5M for Social Network, Promises No Ads or Selling User Data*, WALL ST. J. (Oct. 23, 2014, 6:37 PM), <http://blogs.wsj.com/venturecapital/2014/10/23/ello-raises-5-5-m-for-social-network-promises-no-ads-or-selling-user-data/>.

146. *Id.*

147. *Ello Is a Public Benefit Corporation*, ELLO (Oct. 20, 2014), <https://ello.co/downloads/ello-pbc.pdf>.

148. Chapman, *supra* note 152.

149. *Id.*

150. Blair Henley Frank, *MovingWorlds Raises Cash, Looks to Connect Volunteers with Nonprofits*, GEEKWIRE (May 13, 2014, 1:10 PM), <http://www.geekwire.com/2014/movingworlds-heads-towards-public-launch-seed-round/>.

nects highly-skilled volunteers with social impact organizations around the world.<sup>151</sup> In May 2014, MovingWorlds completed an oversubscribed seed round, raising \$375,000 from several impact investing organizations to fund the public release of its platform.<sup>152</sup>

These examples illustrate that non-charitable social enterprise forms are beginning to attract investment capital from traditional venture capital funds as well as the emerging class of impact investors. Perhaps more interestingly, several investment funds and financial services firms have adopted these new legal structures themselves. For example, Grassroots Capital Management Corp., PBC is a Delaware public benefit corporation that manages approximately \$207 million over four impact investment funds aimed at eliminating poverty through microfinance investments.<sup>153</sup> Grassroots is not alone in this space. In fact, a recent study conducted by Alicia Plerhoples found that seven of the first fifty-five Delaware public benefit corporations provide financial services.<sup>154</sup>

As the examples above make clear, none of the newly authorized social enterprise forms are designed to receive charitable donations from the public. Charitable purpose forms like the L3C were intended to streamline private foundation investments, not donations. Non-charitable purpose forms like the benefit corporation rely on capital markets to raise funds. None of these organizations receive favorable tax treatment, and because these organizations are not tax-exempt, charitable donations to social enterprises are not tax deductible.<sup>155</sup> Even those most sympathetic to the goals of social enterprise would be hard-pressed to make a non-tax deductible donation, especially when those funds could be invested in the social enterprise or used to make a tax-deductible donation to a public

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151. *The MovingWorlds Mission, Story, and Team*, MOVINGWORLDS, <http://movingworlds.org/about> (last visited Nov. 19, 2014).

152. Frank, *supra* note 150.

153. GRASSROOTS CAPITAL MANAGEMENT, <http://www.grassrootscap.com/> (last visited Sept. 25, 2014).

154. Alicia E. Plerhoples, *Delaware Public Benefit Corporations 90 Days Out: Who's Opting In?*, 14 U.C. DAVIS BUS. L.J. 247, 264 n.70 (2014), available at <http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=2351&context=facpub>.

155. See *Publication 526, IRS*, [http://www.irs.gov/publications/p526/ar02.html#en\\_US\\_2013\\_publink1000229641](http://www.irs.gov/publications/p526/ar02.html#en_US_2013_publink1000229641) (last visited Nov. 21, 2014).

charity that pursues a similar mission. In the absence of tax advantages, it seems unlikely that these organizations would succeed in soliciting charitable funds, and there is no data that suggests they are attempting to do so.

C. *Are Social Enterprises Commercial Co-Venturers?*

Even if social enterprises are not “charitable organizations,” and do not “solicit” charitable donations, charitable solicitation acts may still regulate them as CCVs. As discussed in Part I.B. above, these acts regulate for-profit corporations that partner with charities to engage in charitable sales promotions. CCVs are regulated in twenty jurisdictions, and, in general, are subject to certain contractual, disclosure, and accounting requirements.

In those states that regulate CCVs, most have adopted the language of the 1986 Model Act, which defines “commercial co-venturer” as “a person who for profit is regularly and primarily engaged in trade or commerce other than in connection with soliciting for charitable organizations or purposes and who conducts a charitable sales promotion.”<sup>156</sup> Social enterprises are for-profit organizations “primarily engaged in trade or commerce,” and, as established above, they do not “solicit” for charitable organizations or purposes. Thus, whether or not a social enterprise is a CCV depends entirely on whether it conducts a “charitable sales promotion.”

The Model Act defines “charitable sales promotion” as “an advertising or sales campaign, conducted by a commercial co-venturer, which represents that the purchase or use of goods or services offered by the commercial co-venturer will benefit, in whole or in part, a charitable organization or purpose.”<sup>157</sup> As the definition suggests, charitable sales promotions are “advertising or sales campaign[s].” Implicit in this definition is that these campaigns mark a departure from the normal course of business and, more importantly, are offered to consumers for a limited period of time.<sup>158</sup> Indeed, the tem-

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156. 1986 MODEL ACT, *supra* note 36, § 1(h).

157. *Id.* § 1(i).

158. HOPKINS, *supra* note 40, at 67 (“A charitable sales promotion or commercial co-venture is a promotion by a for-profit (commercial) business pursuant to which, *during a stated period of time*, a portion (usually identified as a percentage, perhaps with a cap) of the sales price of a good sold or service

poral element of charitable sales promotions is evident from the context and substance of the relevant provisions of many state charitable solicitation acts. The provisions governing minimum contractual requirements between charities and CCVs require that each contract specify “the geographical area where, and the starting and *final date* when, the offering will be made . . . .”<sup>159</sup> The disclosure provisions for CCVs refer to a “*final date* of the charitable sales promotion.”<sup>160</sup> Lastly, the CCV accounting requirements begin to toll from the “final accounting date.”<sup>161</sup> In short, the co-venture campaigns envisioned by state lawmakers were, like the archetypal American Express/Restoration Project arrangement, *temporary* sales or advertising campaigns conducted by otherwise profit-maximizing organizations.

Like traditional corporations, social enterprises may engage in commercial co-venture partnerships with charities. Indeed, because of their unique nature, social enterprises may be more likely than traditional corporations to seek partnerships with charitable organizations.<sup>162</sup> However, unlike traditional temporary co-venture arrangements, social enterprises that engage in this practice *permanently* commit themselves to these arrangements. From the social entrepreneur’s perspective, arrangements with charitable organizations are not “marketing campaigns” meant to briefly serve a public relations purpose or improve brand image; rather, these partnerships are woven into the fabric of the organization’s business model, and are a means by which the organization achieves its social or environmental purpose. In other words, the co-venture arrangement is not a departure from a corporation’s traditional business model, it *is* the business model.

Indeed, a close reading of the statutory language reveals the clear legislative intent to limit the reach of commercial co-venture regulation to “campaigns” conducted during specified periods of time rather than permanent partnerships between

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proceed will be contributed to one or more charitable organizations.”) (emphasis added).

159. 1986 MODEL ACT, *supra* note 36, § 7(b)(2) (emphasis added).

160. *Id.* § 7(d) (emphasis added).

161. *See id.* § 7(c).

162. *See, e.g.*, TOM’s, <http://www.toms.com> (last visited Sept. 25, 2014) (exemplifying the “buy one, give one” business model of partnering with charities to distribute donated goods).

social enterprises and charitable organizations. On the other hand, state charity regulators may point out that the spirit of these regulations is to protect consumers from misleading marketing or sales campaigns. Recall that CCV regulations are triggered by representations made to the public, and social enterprises that employ a “buy one, give one” business model (or some other iteration of an embedded-giving model) represent to consumers that a portion of the purchase price will benefit a charitable purpose or organization.

Whether state charity officials or the courts are willing to make the temporal distinction drawn by the above analysis remains to be seen. Nevertheless, as this Part has shown, if social enterprises are subject to regulation under state charitable solicitation acts, it is not, as the Colorado Secretary of State suggests, because they are “charitable organizations” that solicit donations from the public. On the contrary, only those social enterprises that adopt business models that embrace the concept of charitable sales promotions are arguably subject to charitable solicitation regulation, and then only as “commercial co-venturers.” Accordingly, the intersection of social enterprise and charitable solicitation acts is much narrower than suggested by some charity regulators.

#### CONCLUSION

This Article has shown that charitable solicitation acts were intended to establish regulations for traditional charitable organizations, and argues that recent attempts to shoehorn innovative for-profit social enterprise forms into this pre-existing regulatory regime contradicts legislative intent. Recent suggestions that these forms may be “charitable organizations” subject to registration and reporting requirements under state charitable solicitation acts misunderstand how social enterprise forms raise funds, and confuses “charitable” purposes with “social” and “environmental” corporate purposes. Instead, a close reading of charitable solicitation acts reveals that some social enterprises, namely those that embrace the concept of charitable sales promotions, may be subject to regulation as commercial co-venturers, not as “charitable organizations.”

Assuming, *arguendo*, that the intersection of these two bodies of law is limited to regulations governing CCVs, the end

result is less than desirable. Because many social enterprises do not employ charitable sales promotions, it would leave a significant percentage of these organizations unregulated. Moreover, if the onerous state-by-state patchwork of CCV regulations are enforced on social enterprises, social entrepreneurs would be disincentivized from adopting a “buy one, give one” or embedded giving business model, which has proven to be a successful innovation for attracting both investors and socially-minded consumers to businesses that seek to address social and environmental concerns.

Because this result does little, if anything, to address the regulatory vacuum in this emerging space, regulators and lawmakers may be best served by seeking guidance from abroad, where the social enterprise sector is more mature. Take, for example, the success of social enterprise in the United Kingdom. After the concept of social enterprise began to gain momentum, the British government established the Social Enterprise Unit to develop strategies to overcome obstacles to growth in the sector.<sup>163</sup> The Unit’s report recommended an action plan that included, *inter alia*, the authorization of a new corporate form—the Community Interest Company (CIC)—and the creation of the CIC Regulator.<sup>164</sup> Parliament followed through on the Unit’s recommendation,<sup>165</sup> and the CIC Regulator was given broad regulatory authority to maintain public confidence in CICs and enforce the “community interest test.”<sup>166</sup> To that end, the CIC Regulator may intervene in CIC affairs, including ordering independent audits, commencing civil proceedings, removing directors, and appointing a manager to run the CIC after directors have been removed.<sup>167</sup> Today, the United Kingdom enjoys the most vibrant social enterprise sector in Europe.<sup>168</sup>

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163. CABINET OFFICE, OFFICE OF THE THIRD SECTOR, SOCIAL ENTERPRISE ACTION PLAN: SCALING NEW HEIGHTS 10 (2006).

164. *Id.* at 14.

165. *See* COMPANIES (AUDIT, INVESTIGATIONS AND COMMUNITY ENTERPRISE) ACT, 2004, c. 27, § 26-40 (U.K.) [hereinafter COMPANIES ACT].

166. The Community Interest Company Regulations, 2005, S.I. 2005/1788, pt. 2, ¶ 4 (U.K.); *see also* Stephen Lloyd, *Transcript: Creating the CIC*, 35 VT. L. REV. 31, 34–35 (2010).

167. *See* COMPANIES ACT, *supra* note 165, at §§ 27, 43–44, 46–47.

168. BMG RESEARCH CABINET OFFICE, SOCIAL ENTERPRISE MARKET TRENDS (2013), *available at* [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/205291/Social\\_Enterprises\\_Market\\_Trends](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/205291/Social_Enterprises_Market_Trends)

In the United States, corporations are creatures of state law, and thus a federal regulatory agency tasked with overseeing social enterprises like the U.K. CIC Regulator is unlikely to emerge. At the state level, charity regulators are ill-equipped to shoulder the additional burden of monitoring and commencing enforcement actions against a new and unfamiliar class of organizations. Indeed, state charity officials are notoriously under-funded, under-staffed, and capricious in their selection of enforcement actions.<sup>169</sup> State lawmakers in the United States should learn from the United Kingdom's success in fostering social enterprise. Effective enforcement of social enterprises will not come from antiquated regulatory regimes. Rather than continue efforts to impose nonprofit regulations on for-profit social enterprises, state lawmakers should recognize that regulatory certainty requires a specialized regulatory agency that is designed to accommodate the social enterprise sector's unique and complex array of corporate purposes.

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\_report\_v1.pdf (finding that there are approximately 70,000 social enterprises in the United Kingdom employing nearly one million people).

169. Lloyd Hitoshi Mayer & Brendan M. Wilson, *Regulating Charities in the Twenty-First Century: An Institutional Choice Analysis*, 85 CHI.-KENT L. REV. 479, 480 (2010); ELEANOR K. TAYLOR, PUBLIC ACCOUNTABILITY OF FOUNDATIONS AND CHARITABLE TRUSTS 125 (1953) (expressing similar concerns with respect to both charitable trusts and charitable organizations); *see also* Reiser, *Theorizing*, *supra* note 17, at 722 ("The understaffing and lack of resources in charities bureaus has been discussed by virtually every commentator in the field and is, by now, widely accepted as both problematic and unlikely to change. Attorneys general simply lack the capacity to do more enforcement without greater resources.") (footnote omitted).