

NEW APPROACHES TO REGULATION OF CHARITABLE SOLICITATION*

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The duty of every man is to devote a certain portion of his income for charitable purposes and ... his further duty is to see it applied to do the most good.

Thomas Jefferson

Charitable solicitation is a \$100 billion business.¹ Like any business its participants are faced with competition, and abuses by some of its industry members occur. Unlike some for profit businesses, there often is no discernible outcome after a charitable contribution has been made. A contribution is usually an act of faith that money donated is put to its promised use. Indisputably, fraud in charitable solicitation exists. Misuse of monies raised for charitable purposes is not only a fraud upon the donor, it can be a diversion of tax dollars from state or federal treasuries. It has been long decided that the state could use its police powers to limit and regulate charitable solicitation to ensure that charitable dollars are efficiently spent and public benefits maximized. This power of regulation is limited by constitutionally imposed boundaries.

In response to the problems of charitable solicitation, a majority of states have developed elaborate registration and filing systems whereby charities and fundraising solicitors must register, file annual reports, and notice of any changes in their status. There are three common prongs to these regulatory schemes. First is mandatory disclosure whereby thorough state and local registration and licensing requirements, financial and operational information is made available to the public. Second, the statutes make unlawful any fraudulent solicitation activities carried on by groups

1. Harris, Holley, S. McCaffrey, Fundraising in to the 1990s State Regulation of Charitable Solicitation. After Riley 1 (1989) citing American Association of Fund-Raising Counsel, Inc. Giving USA: The Annual Report on Philanthropy for the Year 1988 (1989) [hereinafter HARRIS, HOLLEY & McCAFFREY]

purporting to represent charities, by charitable groups, or by professional solicitors. Penalties range from cancellation of registration to penal sanctions. Third, states have included provisions controlling the costs of solicitation and administration so as to increase the percentage of funds directly spent on the exact purposes of the organization.² This last approach has been the subject of extensive litigation including three recent Supreme Court cases.³ Because attempts to force disclosure of or regulate costs of fundraising impinge upon First Amendment concerns, this issue has attracted by far the most attention in the courts and interest by the charitable sector.

This paper discusses some non-constitutional issues relating to enforcement of charitable solicitation and offers suggestions for improved enforcement. The paper commences by questioning the assumptions of existing legislation and then examines possible alternatives: the development of a self-regulating system by exempt organizations and professional fundraisers; broadening standing requirements to challenge organizations' tax exemptions; and increasing the use of relator status by which attorney general could appoint individuals or public interest law firms to prosecute charitable fraud.

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2. Quandt, The Regulation of Charitable Fundraising and Spending Activities, 1975. Wis. L. Rev. 1158, 1160 (1975).
 3. *Schaumburg v. Citizens for a Better Environment*, 444 U.S. 620 (1979); *Secretary of State of Maryland v. Joseph H. Munson Co.*, 467 U.S. 947 (1984); *Riley v. Nat'l Federation of the Blind of North Carolina, Inc.* 108 S.Ct. 2667 (1988).

I. THE EXISTING REGULATORY SCHEMES: RATIONALES AND REALITY

As an outside observer to regulation of charitable solicitation, one is shocked by how tenuous the rationales of the statutory schemes are to the realities of private giving or charitable fraud. A majority of jurisdictions require charities and professional fundraisers to disclose information about themselves by filing with the state or to make disclosure to potential donors. The theory behind mandatory disclosure is that an informed potential donor will be able to make a reasoned decision based upon the facts disclosed. In Telco Communications v. Carbaugh,⁴ the Fourth Circuit held that a section of the Virginia Code which required professional solicitors to disclose in writing that a financial statement for the last fiscal year was available promoted the state's interest in adding to public knowledge of professional solicitors. The Court said that the disclosure requirement educated the public generally about the availability of financial information about other solicitors is available.

A donor can use this information to determine if a particular solicitation is bona fide by ascertaining whether the solicitor is registered. A donor might also use this information to learn further about a solicitor's operations. Additionally, this section assists in preventing fraud. When comparative information is available, inaccuracies in inducements are less likely to appear. If they do occur, they are more likely to be discovered.⁵

In Riley v. National Federation of the Blind of North Carolina, the Supreme Court suggested a more benign and narrowly tailored disclosure option than the statute under review. The State could publish the detailed forms it required professional fundraisers

4. 885 F.2d 1225 (4th Cir. 1989).

5. Id. at 1231-32.

to file. These procedures, suggested the Court, would communicate the desired information without burdening speakers with unwanted speech during the course of a solicitation.

The theory of disclosure to donors may have little to do with the typical transaction between contributor and solicitor. It assumes a sophisticated donor who will ask questions or inspect financial information and who then will be able to differentiate between a worthwhile and a fraudulent charity. This disclosure model may apply correctly to corporations, foundations, and a few major donors with the experience and resources to evaluate the information. Unsophisticated donors have neither the expertise nor inclination to make such an investigation.⁶

Most donors who would take the trouble to obtain the financial information would probably not contribute if any suspicion had been aroused. Those who have made donations and later receive information by mail that displeased them theoretically could cancel their checks, but this assumes a postal system that is but a fantasy. Richard Steinberg has suggested that some donors may be too cynical to ask solicitors questions, believing charities with something to hide would not tell the truth anyway. What is to prevent the dishonest solicitor or charity from filing false returns? The chances of discovery may be slim and to the inquiring donor nil.

All disclosure requirements assume that donors really care about how the money they contribute will be used. This may not always be so. People donate for a variety of

6. Steele, Regulation of Charitable Solicitation: A Review and Proposal, 13 J. Legis. 149, 190 (1986) [hereinafter Steele].

motivations of which ensuring that their dollars are efficiently spent are but one. To some extent giving is like voting. One reason people vote is that it is an extremely inexpensive mechanism for self-expression and self-definition. The vote costs nothing because the probability an individual's vote will be decisive in a particular election is effectively zero.⁷ Voting is an inexpensive way for people to feel patriotic, self righteous and altruistic. Some charitable giving may be explained by the fact that the feeling of altruism is more important than the object of the gift. The biblical maxim that "it is better to give than receive" may be grounded in psychological behavior. Other less altruistic reasons may be tangible benefits -tax deductions, benefit dinners and balls, fear of social disapproval at work or in the community, or desire to please the solicitor - a friend, a girl scout, or as likely, the scout's parent. The statutory structure and some of the judicial decisions adapt a one dimensional view of why people donate.

Many of the statutes provide exemptions from the registration and reporting requirements. While most are understandable on grounds of avoiding constitutional problems or promoting administrative husbandry, they do not relate to the problems of charitable solicitations. For instance, religious organizations are often exempt from the filing and other requirements because of fears of first amendment entrapments. While this concern is valid, recent events demonstrate that religious organizations are no less likely than other exempt activities to engage in improper fundraising.

Some states have exempted membership organizations from the registration

7. Lee, Politics, Ideology and the Power of Public Choice, 74 Va. L. Rev. 191, 193 (1988).

requirements.⁸ The justification for this exemption is that the interest of the State is in protecting the general public from fraud. When membership organizations solicit their own constituency, it is appropriate to regard such solicitations as private and beyond the purposes of state regulation.⁹ Given a state's limited resources, the membership exemption allows their allocation on public solicitations.¹⁰ This rationalization is questionable and clearly makes no sense if the goal of charitable regulation is to assist in enforcement against violators. Members in this context are analogous to shareholders in business corporations who usually have standing to sue an organization or its directors. Presumably, members also have an interest in the goals of the organization and would be distressed if funds were diverted or otherwise misused. Filing requirements for membership organizations would assist members, who are more knowledgeable about the organizations aspirations, to correct abuses through corporate democracy by replacing the directors or through litigation. Members, who are often kept ignorant of an organization's financial affairs, would be more likely to sue on the basis of information in the registration data than anyone else.

Sometimes, the membership and religious exemptions collide. In Heritage Village Church and Missionary Fellowship v. State¹¹ held unconstitutional was a statute which

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8. See, e.g. N.Y Exec. Law § 172-a(b) (McKinney 1990), Cal. Bus. & Prof. Code § 17510.3 (Deering Supp. 1990).
 9. Nat'l Fdn. v. City Fort Worth, 415 F.2d 41, 48 (5th Cir. 1969) cert denied 396 U.S. 1040 (1970); B. HOPKINS, CHARITY UNDER SIEGE 90 (1980)[hereinafter HOPKINS].
 10. Steele, supra note 6 at 181.
 11. 299 N.C. 399, 263 S.E.2d 726 aff'g 40 N.C. App. 429, 253 S.E.2d 473 (1980).

exempted religious organizations from a licensing requirement provided the organization's budget was derived primarily from membership contributions. Other religious organizations which solicited beyond their flock had to obtain a license. There was no similar exemption for non-religious organizations. The court rejected the underlying assumption of the exemption clauses of the statute that funds solicited within the organization would not be solicited or expended in a fraudulent manner whereas funds solicited outside of the organization would not be subject to fraud. Also disapproved was the idea that the membership would keep closer tabs upon organizational officials in contrast to organizations which solicited outside the general public.¹²

Similarly in Larson v. Valente,¹³ the United States Supreme Court found unconstitutional a Minnesota statute which exempted religious organizations if more than half of their contributions were received from members or parent or affiliated organizations. The court rejected the premise that members of a religious organization can and will exercise supervision and control over the organization's solicitations when contributions from members exceed fifty percent, that membership control is an adequate safeguard, and the need for public disclosure rises in proportion with the percentage of non-member contributors.¹⁴ In contrast to the assumptions of the legislation, membership monitoring might be an adequate safeguard if the organization

12. Id. at 411-412, 263 S.E.2d at 733.

13. 456 U.S. 228, 1982.

14. Id. at 248-249.

had to file the same information as other exempt organizations.¹⁵

Another common exemption is based upon organizational size. Smaller charities, determined by the amount raised or annual budget, are exempt from filing requirements. This exemption is justified because it would be cost inefficient for smaller organizations to comply with the statute and for regulators to enforce compliance. However, there is probably no direct correlation between smallness and probity. Most likely, the relationship is inverse. That is, smaller organizations because of their general lack of financial sophistication are more likely to deviate from acceptable norms and practices.

Many statutes exempt educational institutions, libraries, hospitals or other institutions on grounds they are closely regulated by other state agencies. However, these other state agencies are usually interested in outputs - the quality of product delivered, rather than inputs, how funds are solicited from the public. Contributors may not realize they have to contact other agencies for information about certain kinds of organizations.

The regulation of fundraising costs has been the subject of the most controversy. These statutes have required disclosure of the percentage of contributions to be allocated to the costs of fundraising, mandated disclosure of the fee arrangement which exists between the solicitor and the represented charity, prevented charitable

15. The statutes in Heritage and Larson faced an additional difficulty because they exempted some religious organizations from the burdens of the registration while less traditional religions which had to obtain support outside of the membership had to comply with the statutory obligation. This was violative of the establishment clause. Steele, supra note 6 at 179-180.

organizations from paying expenses over a certain percentage, or denied solicitation permits or licenses to organizations that expended more than a sum the legislation deemed reasonable.¹⁶ Constitutional grounds for objection have been that such legislation is violative of free speech, free exercise of religion or freedom of the press. Basically, the Supreme Court has held that one cannot separate the solicitation of funds or the requirements of solicitors to produce information to donors from the communications of ideals, a traditionally protected activity.¹⁷ Most of the legislation dealing with fundraising percentages is constitutionally overbroad, yet the state still has the power to curtail fraudulent activity and to require disclosure that is less intrusive.

In Riley, the Court said in dictum that "... nothing in this opinion should be taken to suggest that the State may not require a fundraiser to disclose unambiguously his or her professional status. On the contrary, such a narrowly tailored requirement would withstand First Amendment scrutiny".¹⁸ The Court suggested more benign and narrowly tailored options. It gave as an example that the State may itself publish the detailed financial disclosure forms it requires professional solicitors to file which would communicate the desired information to the public without burdening a speaker with unwanted speech in the course of his solicitation.¹⁹ Publication might be of help to investigative reporters or foundations or corporations considering a sizable grant, but

16. See HARRIS, HOLLEY & McCAFFREY, supra note 1 at 59-60.

17. Steele, supra note 6 at 166.

18. 108 S.Ct. at 2679.

19. Id.

publication will assist the typical prospective donor no more than the right to request a copy of the organization's latest annual report²⁰ unless such requests somehow become commonplace.

In fact the fundraising percentage requirements have little meaning. So many factors comprise solicitation costs: the nature of the organization, the approach of the purchasing campaign, techniques used, the purpose of the campaign. There is no certain evidence that high fundraising costs are indicative of fraud, just as low fundraising costs are not indicative of efficient or reasonable costs.²¹ The fundraising percentage disclosure statutes make assumptions that have neither empirical basis nor psychological sense.

An unchallenged part of the statute in Riley required professional fundraisers to disclose their professional status to potential donors thereby giving notice that at least a portion of the money contributed will be retained. The Supreme Court assumed that the public had some intelligence - a fact that the percentage disclosure statutes do not seem to admit - by noting "Donors are also undoubtedly aware that solicitations incur costs, to which part of their donation might apply. And, of course a donor is free to inquire how much of the contribution will be turned over to the charity."²² The court pointed out that if the solicitor refused to give the requested information, the potential

20. See N.Y. Exec. Law § 174-b (McKinney 1990).

21. *Sec'y State v. Munson*, 467 U.S. at 966-967, *Hopkins*, supra note 9 at 112.

22. 108 S. Ct. at 2679. Another North Carolina statute required fundraisers to disclose this information on request.

donor may (and probably would) refuse to donate.²³ It is likely that a donor who even asked for such information would be a very reluctant contributor.

Publication of the information on disclosure forms might force charities to justify their costs. If donors become generally aware that such documents were available they might regularly request to see them and use them as a basis for deciding to give. At this point in time, the mandatory disclosure system seems an expensive edifice that is unused by the public, increases agency costs for the charitable sector, and does relatively little to thwart abuses.

Another option suggested by the Supreme Court in Riley was that the state should vigorously enforce its anti-fraud laws to prohibit professional fundraisers from obtaining money by false pretenses or by making false statements.²⁴ However, enforcement by state attorneys general is slow and time consuming and limited by the scarce resources that most offices can devote to enforcement of charitable fraud. It can take a long time to build a case. Many states have almost no staff to conduct intensive investigations which lay the groundwork for successful enforcement.

Charitable fraud is not insubstantial. Some scams are nationwide and fraudulently elicit millions of dollars, but state attorneys general have many competing demands on their resources. In the overall picture of state enforcement how important is charitable fraud compared to other issues of crime and defalcation or other matters of importance to the state? How much of an additional burden do we want to place upon

23. Id.

24. Id.

law abiding charities if we build an efficient monitoring and enforcement system? In the context of society's other problems, how important is this issue?

The scale of the registration and disclosure framework seems immense given the scope of the voluntary sector compared to the resources available for enforcement. Much of the regulation is really registration and reporting. The paucity of staff means in reality there is no true monitoring of activity. Richard Steinberg has commented that mandatory disclosure appears unnecessary but harmless.²⁵ Under present capabilities it may be harmless, but it is not unnecessary. The registration and disclosure systems create a series of hoops for solicitors and charities that indicate the seriousness of the state's attempts to crack down on such fraud. They also inform the fraudulent fundraiser that misrepresentations, discrepancies, omissions, or misstatements build a record which can be used in prosecution of statutory violators. If the public could be trained to ask questions or to demand disclosure and registration statements, and if somehow attorneys general could readily act upon abuses, the mandatory disclosure systems would be more useful. To improve enforcement of solicitation abuses there is a need to make the current system more effective or to seek alternative approaches.

25. Steinberg, Economic Perspectives on Regulation of Charitable Solicitation, 39 Case West. Res. L. Rev. 775, 794 (1988-89)

II. IMPROVING THE EFFECTIVENESS OF STATE REGULATION OF CHARITABLE ORGANIZATIONS

A. EXPANDING STANDING LIMITATIONS

Directors of charitable corporations generally have standing to sue, but they rarely bring derivative suits. Members of charitable corporations may have standing to sue.²⁶ However, many nonprofit corporations are non-membership corporations with self-perpetuating boards. For this latter sort of organization only the attorney general or a director has standing to bring suit.²⁷

Under trust and corporate principles, the public has no standing to sue absent a specific statutory grant. The rationale is that property is devoted to the accomplishment of purposes which are beneficial to the community at large, rather than to a specific person.²⁸ Even a specific beneficiary of a charity is but an intermediary through whom the public advantage is achieved. Therefore, enforcement of charitable purposes is

26. See CAL. CORP. CODE § 5420, 7420, 7710 (West Supp. 1990); N.Y. NOT FOR PROFIT CORP LAW §§ 623(a), 720(b)(3) (McKinney 1990) REV. MODEL NON PROFIT CORP. ACT § 6.3, Hansmann, Reforming Nonprofit Corporation Law, 129 U.Pa. L. Rev. 97. 606 (1981)(while most statutes are silent on standing questions, they generally adopt charitable trust rules). Some state courts have given standing to members; others have not. Compare Leeds v. Hanson, 7 N.J. Super. 588, 72 A.2d 371 (1950) with Voeller v. St. Louis Merchantile Library Ass'n, 359 S.W.2d 689 (Mo. 1962).

27. See N.Y. NOT-FOR-PROFIT CORP. LAW §§ 720(c), 112 (McKinney 1990).

28. 4 A. SCOTT, THE LAW OF TRUSTS § 364 (3rd ed. 1967)[hereinafter SCOTT]; [Tushnet, The New Law of Standing, 62 Cornell L. Rev. 663, 675 (1977).

undertaken by the attorney general on behalf of the public.²⁹ A more practical reason for denying the public standing is that the person benefitted by charities are usually members of a large and shifting class of the public. If any member of that class had standing, the charity would be subjected to much unnecessary litigation.³⁰

Traditional standing limitations occasionally have been relaxed in matters of public importance that relate to charities.³¹ The general rule, however, remains that,

29. G.G. BOGERT & G.T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 54 (rev. 2d ed. 1979) (quoting *In re Pruner's* Estate, 390 Pa. 529, 136 A.2d 107 (1957)). [hereinafter BOGERT & BOGERT].

30. *Id.* at § 411.

31. *See* *Fitzgerald v. Baxter State Park*, 385 A.2d 189 (Me. 1978) (Land was conveyed to the state as a trust for a state park. The park authority and attorney general as members of former trustees were to carry out the purposes of the trust. Plaintiffs as Maine citizens and users of park were given standing to sue); *Gordon v. City of Baltimore*, 258 Md. 682, 267 A.2d 98 (1970) (taxpayer had standing to sue to prevent transfer by charitable corporation of its library to another corporation so that city of Baltimore would support library); *Jones v. Grant*, 344 So.2d 1210 (Ala. 1977) (faculty, staff, and students had standing to bring class action against president and board of directors for misuse of funds); *Parson v. Walker*, 28 Ill. App. 3d 517, 328 N.E.2d 920 (1975) (citizens have standing to oppose deviation of gift of land made to state university for park); *Patterson v. Patterson General Hospital*, 99 N.J. Super. 514, 235 A.2d 487 (1967) (residents of city and taxpayers had standing to sue to prevent relocation of hospital). *But see* *Simon v. Eastern Ky. Welfare Rights Org.*, 426 U.S. 26 (1976) (indigents had no standing to maintain an action against the Secretary of the Treasury and internal Revenue Service in order to set aside a ruling that a nonprofit hospital was exempt from taxation even though it did not provide free or below-cost services to the poor); *Stern v. Lucy Webb Hayes Nat'l Training School for Deaconesses and Missionaries*, 367 F. Supp. 536, 540 (D.D.C. 1973) (patients of hospital certified as a class under Fed. R. Civ. P. 23(b)(2) for purposes of seeking injunctive relief in advance of damages to be paid into hospital funds. Certification denied under Fed. R. Civ. P. 23(b)(3), which might entitle patients to receive monetary recovery); *Christiansen v. National Savings and Trust Co.*, 683 F.2d 520 (D.C. Cir. 1982) (subscribers of health plan did not have standing to enforce director's fiduciary duties).

absent a statutory right, there is no private enforcement of a charitable trust, a nonprofit trust, or a nonprofit corporation. Nor should the general public have standing to bring an action. The effects of a suit on a charitable organization are often more severe than those typically resulting for a business corporation or an individual. Publicity generated by the mere bringing the action may dry up sources of funds. The reputation of the organization may never recover. Nevertheless, the enforcement problems remain, and abuses do occur.

One way to improve enforcement of charitable solicitation might be to increase the number of people who could sue to enforce state registration or disclosure requirements. Obviously a person who has been defrauded of money from a misstatement made in the course of a solicitation has a cause of action against the perpetrator for common law fraud. Just as clearly, almost no donor would bring such a suit. The costs of litigation are so great that even a class action would require extensive investigation without sufficient promise of recovery of lost funds. One alternative might be to allow individuals to seek revocation of the tax exemption of the offending charity. To maintain such an action a plaintiff would have to prove standing to bring such a suit.

IRC § 7248 provides that an organization denied 501(c)(3) status may seek judicial review of that determination, but does not permit third party challenges to an IRS exemption concerning exemption. In addition, section 7421(a), the Anti-injunction Act, provides that no suit for the purpose of restraining the assessment or collection of any tax can be maintained whether or not such person is the person against whom such tax

is assessed.³²

However, some courts have held that parties who owe no tax themselves but who seek the collection of tax from another are not barred from seeking judicial review by the Anti-Injunction Act.³³ Conceivably, one might attack organizations that engage in fraudulently soliciting funds which are not thereafter used for charitable purposes by bringing suit to enforce the collection of taxes that would otherwise be due the government absent the inappropriate grant of exemption. Compared to revocation of an organization's tax exempt status, a suit to force collection of taxes would be an indirect, inefficient, and probably unsuccessful method of regulating fraudulent solicitation.

A primary hurdle in challenging an organization's exemption is whether the third party has standing to bring such an action; that is "whether the plaintiff has alleged such a personal stake in the outcome of the controversy as to warrant his invocation of federal court jurisdiction and to justify the exercise of the court's remedial powers on his behalf."³⁴ A plaintiff must allege personal injury fairly traceable to the defendant's allegedly unlawful conduct and likely to be redressed by the requested

32. One contesting a tax assessment must pay the tax and then sue for a refund. See, *Alexander v. "Americans United" Inc.*, 416 U.S. 752 (1974).

33. See *Tax Analysts and Advocates v. Schulz*, 376 F. supp. 889, 894 (D.D.C. 1974) ("an action to force the collection of that tax is clearly outside the scope of both the language and intent of section 7421(a) (emphasis in original). But see *Barrette v. Phoenix Gen. Hosp.* 58 A.F.T.R. 2d 86-5685, 5687 (D. Ariz. 1986) (The Anti-Injunction Action Act barred a challenge to another's tax exemption).

34. *Warth v. Seldin*, 422 U.S. 490, 498-499 (1975) quoting *Baker v. Carr*, 369 U.S. 186, 204 (1962).

relief.³⁵ Thus, the plaintiff's injury must be distinct and palpable, and relief from the injury must be likely to flow from a favorable decision.³⁶ A third party's challenge to a grant of tax exemption must demonstrate that the alleged injury is fairly traceable to the assertly unlawful conduct of the IRS.³⁷ Essentially plaintiffs must meet a three part test: 1) a distinct personal injury; 2) direct traceability; and 3) possible redress by the defendants. For plaintiffs to succeed the Supreme Court has demanded clear causation between the plaintiff's injury and the challenged governmental conduct.

In Simon v. Eastern Kentucky Welfare Rights Organization³⁸ the Supreme Court denied standing to plaintiffs, various health and welfare organizations and several private citizens, all of whom alleged indigency and inability to pay for hospital services. Plaintiffs challenged an IRS Revenue Ruling that granted charitable status to hospitals even though they failed to operate to the extent of their financial ability when refusing medical services for indigent patients. Plaintiffs claimed that they were the intended beneficiaries of this favorable tax treatment and that the IRS had violated the Internal Revenue Code by granting tax exemption.³⁹ The Court found that the injury alleged was not one that fairly could be traced to the challenged action of the government. It was "purely speculative" whether the denial of access to hospital services was related to

35. Valley Forge Christain College v. Americans United for Separation of Church and State, Inc. 454 U.S. 464, 472 (1982).

36. See Simon v. Eastern Kentucky Welfare Right Org. 426 U.S. 26, 38 (1976).

37. Allen v. Wright, 468 U.S. 737, 753 (1984).

38. 426 U.S. 26 (1976).

39. Id. at 28.

the Government's grant of tax exempt status, primarily because the hospitals were probably making their service decisions without regard to the tax implications of the decision.⁴⁰

Another case where plaintiffs were prevented from challenging a grant of exempt status because of a failure to show directly traceable injury from the Government's action was Allen v. Wright.⁴¹ The Service denied tax exempt status to racially discriminatory private schools. Plaintiffs, parents of black children who were attending public schools in seven states in school districts undergoing desegregation, brought a class action against the Government alleging that the Service had not adopted sufficient standards and procedures to fulfill its obligations to deny exempt status to racially discriminatory private schools.⁴² The plaintiffs alleged that the IRS had thereby harmed them directly and interfered with their children's opportunity to receive an education in desegregated public schools. Since many racially segregated private schools were created in communities undergoing desegregation, the IRS's actions were alleged to have harmed plaintiffs because the exemptions constituted tangible financial aid for racially segregated schools enabling white students to avoid attendance in desegregated public educational institutions. The children had not been denied entrance to the alleged discriminatory private schools.

The Court found the parents had no standing. The lack of desegregated schools,

40. Id. at 42-43.

41. 468 U.S. 737 (1984).

42. Id. at 766.

itself a cognizable injury, was not sufficiently related to the government action. "From the perspective of the IRS, the injury to respondent is highly indirect and results from the independent action of some third party [the discriminatory private school] not before the court".⁴³ The links in the chain of causation were too weak. To meet the traceability requirement, there would have to be enough racially discriminatory schools receiving exemption in the plaintiff's community to make an appreciable difference in public school integration. In addition, the Court found it entirely speculative whether the withdrawal of tax exemption would cause the schools to change their policies.⁴⁴

In the context of charitable solicitations the question becomes whether one could challenge the IRS's grant of tax exemption. The possibilities are not great in the absence of a constitutional objection to the grant of such status.⁴⁵ As Justice Stewart

43. Id. at 757.

44. Id. at 758,

45. There is a line of cases that have granted standing to plaintiffs alleging that the government failed to enforce the lobbying restrictions against 501(c)(3) organizations, and such failure afforded a competitive advantage to those groups and correspondingly diminished plaintiff's effectiveness in the political arena. See In Re United States Catholic Conference, 855 F.2d 1020, 1028-29. Note, Standing to Challenge Tax-Exempt Status: The Second Circuit's Competitive Political Advocate Theory, 58 Ford L. Rev. 723 (1990). This is not particularly relevant here. Other cases have held that a federal ruling which confers unfair economic advantages on a competitor and injures a plaintiff would confer standing. The plaintiff must show that he personally competes in the same area with the party to whom the government bestowed the asserted illegal benefit. Economic competitor cases arose when banks moved into new business areas such as data processing and became competitors of firms that had traditionally provided those services. The Supreme Court held that organizations from which banks sought to take away business had standing to challenge banks' expansion into non-banking functions. See Clarke v. Securities Indus. Ass'n, 479 U.S. 388 (1987); Association of Data Processing Serv. Orgs. v. Camp, 397 U.S. 150 (1970). It might be extremely difficult to prove that the

commented in a concurring opinion in Simon, he could not "imagine a case, at least outside the First Amendment area, where a person whose own tax liability was not affected ever could have standing to litigate the federal tax liability of someone else".⁴⁶

Under the requirements for standing it is doubtful that a plaintiff could meet the burden of demonstrating the link between a charities' tax exempt status and the fraudulent solicitation. When one has been defrauded by an improper charitable solicitation the chain of causation between the challenged governmental conduct and the asserted injury is too tenuous. Nor is the alleged injury traceable to the challenged governmental conduct. Withdrawal of federal tax exemption may not lead to appreciable differences in fundraising capability.

Organizations might remain exempt under state law. Many of the more gullible contributors are the least affluent. They may have little interest in the tax exempt status of the soliciting organization, for they receive no tax benefits from a donation. Exempt status is only one factor that encourage people to donate. Tax exemption only signifies that the government has determined that the organization has charitable purposes.

There is an insufficient connection between the defrauded contributor and the exemption. Essentially, this approach would rely on the tax laws to police activities in a

granting of tax exemption to a charity who violates charitable regulation statutes would harm economically a plaintiff who happens to solicit for a similar cause. All exempt organizations seek money from the public and in a sense compete against one another. If standing was granted, almost any exempt organization could have standing against another.

46. 426 U.S. 26, 46 (1976)(Stewart, J. concurring).

manner for which they are not suited.⁴⁷

B. INCREASING THE USE OF REALTORS

Supervision of charities in the United States has long been exercised by the state attorney general or, in a few jurisdictions, by a district attorney.⁴⁸ Even before the Statute of Charitable Uses of 1601, the attorney general had the responsibility to enforce the purposes of charitable organizations.⁴⁹ According to Blackstone, the source of the attorney general's power was the monarch as parens patriae who had general superintendence of all charities. This oversight was exercised through the throne's chief aide, the Chancellor. Whenever it was necessary to enforce a charity, the attorney general "at the relation of some informant (who was usually called the relator), filed ex officio an information in the court of Chancery to have the charity properly established."⁵⁰ Usually suit is brought by the attorney general on his own initiative, but in a few states suit may be brought by the attorney general on the relation of, or the information of, a third person.⁵¹ That person is called a "relator."⁵² Attorneys general

47. Cf. M. FREMONT-SMITH, FOUNDATIONS AND GOVERNMENT 189 (1965).

48. BOGERT & BOGERT, supra note 29 at § 411.

49. 4 SCOTT, supra note 28 at § 391.

50. 3 W. BLACKSTONE, COMMENTARIES * 427.

51. See Brown v. Memorial Nat'l Home Found., 162 Cal. App. 2d 513, 329 P.2d 118 (Cal. Ct. App. 1958) Sarkays v. Independent Schl Dist., 592 P.2d 534 (Okla. 1979).

52. The relator did not exist at common law but was a creature of the Statute of Anne, 9 Anne, ch. 20 (1710). That act provided that it should be lawful "for the proper officer, by leave of the court, to exhibit an information in the nature of a quo warranto at the relation of any person desiring to prosecute the same."

have a multiplicity of responsibilities and extremely limited resources. The thousands of nonprofit corporations, combined with the lack of resources devoted to monitoring means charitable organizations are for all practical purposes self-regulated. The attorney general can designate the relator to represent the state's interest.

A relator is a party who may or may not have a direct interest in a transaction, but is permitted to institute a proceeding in the name of the people when that right to sue resides solely in the attorney general.⁵³ Expanding the use of relators could complement state enforcement yet avoid the dangers of broadened standing by members of the public. The resources needed for the effective regulation of nonprofits are great. The use of relators offers a cost effective approach preferable to expanded government regulation. This use of relators is derived from the quo warranto proceeding.⁵⁴ Usually a relator must have a direct interest in the matter of the

The statute was adopted in toto by some states. *Newman v. United States*, 238 U.S. 537, 544 (1914). Jurisdictions differ on the procedures to be followed to institute an action on behalf of a relator and whether the Attorney General can control an action once brought.

53. *Brown v. Memorial Nat'l Home Found.* 162 Cal. App. 2d 513, 329 P.2d 118 cert. denied, 358 U.S. 943 (1958).

54. Quo warranto is an extraordinary civil proceeding whereby the state demand that an individual or corporation show by what right some franchise or privilege has been granted by the state. Quo warranto can be resorted to only when the actor wrong complained of does injury to the public. See generally 5 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* §§ 2324-29 (rev. per. ed. 1976). In most American jurisdictions, there are constitutional or statutory provisions for the exercise of this remedy. Quo warranto can be an appropriate proceeding to challenge the validity and legality of a corporation's existence, to remedy usurpation, misuse, abuse, or nonuse of franchises or privileges, to reach criminal or illegal acts, to oust corporate officers, to try title to a corporate office. *Id.* at § 2330. The theory of this use of quo warranto is that corporations have been granted a franchise

proceeding. Jurisdictions differ regarding whether a relator must seek permission of a court in order to bring suit and the formal status the relator occupies as a party to the litigation. There are three variations: 1) the relator may appear as an ordinary party plaintiff and bring suit in his own name; 2) the state may be the nominal party plaintiff with the relator suing in his own name of the state, formally appearing in the title as relator; and 3) the public attorney may appear as relator. In the latter situation, the role of the private party may be as active as a nominal party plaintiff would be or as passive as the complaining witness in a criminal matter.⁵⁵ State statutory approaches differ greatly. Some jurisdictions have incorporated the quo warranto action under other labels while enforcing state regulation requirements relating to corporations. Typically, these actions are brought by the attorney general for involuntary dissolution of a corporation or failure to adhere to the terms of corporate franchise.⁵⁶

Some jurisdictions complement the state regulation of charities by allowing relators to file with the attorney general information alleging abuses by charitable organizations. In this situation, the suit may be brought by the attorney general or on relation of a third person, who need not have a direct interest in the matter. The attorney general, rather than the relator, has control over the conduct of the lawsuit,

from the legislature and that the usurpation of the corporate office or improper activities by the officers or directors is a violation of the privilege granted by the state. Quo warranto has been used against charitable corporations. See cases cited id. at § 2332 nn. 17-20.

55. Annot. 51 A.L.R.2d 1306, 1309 (1957).

56. See § GA. CODE ANN. § 14-3-217 (Michie 1989)(failure to file an annual report) ILL. ANN. STAT. ch 32, § 163a 49, 50 (Smith Hurd 1973 & Supp. 1989-90) (answering interrogatories falsely and fraudulent solicitation of money).

but the relator is liable for costs, which otherwise would have to be paid by the state.⁵⁷

Relator status has been granted in the nonprofit context to bar associations,⁵⁸ taxpayers,⁵⁹ cemetery plot holders,⁶⁰ directors of other state departments,⁶¹ and members of a social club.⁶²

One jurisdiction where an expanded use of relator status has complemented the attorney general's regulation of charities is California.⁶³ According to regulations promulgated by the California attorney general, the relator submits to the attorney general an application for leave to sue, a verified complaint, and a statement of facts as to why the proposed proceeding should be brought in the name of the state and under the state's jurisdiction.⁶⁴ If the attorney general grants the application, the relator must post a five hundred dollar bond and agree to pay for any costs and expenses recovered

57. *Sarkeys v. Independent School Dist. No. 40*, 592 P.2d 529 534 (Okla. 1979); G.G. BOGERT & G.T. BOGERT, supra note 29, at § 411.

58. *People ex. rel. L.A. Bar Assoc. v. California Protective Corp.*, 76 Cal. App. 2d 354, 244 P. 1089 (1926).

59. *People v. Thompson*, 101 Ill. App. 2d 104, 242 N.E.2d 49 (1968).

60. *State of Kansas ex. rel. Londerholm v. Anderson*, 195 Kan. 649, 408 P.2d 864 (1965).

61. *People ex. rel. Brown v. Illinois State Trooper Lodge No. 41*, 7 Ill. App. 3d 98, 286 N.E.2d 524 (1972).

62. *State of Florida ex. rel. Van Aartsen v. Barton*, 93 So.2d 388 (Fla. 1957).

63. The statutory authority is CAL. CIV. PROC. CODE § 803 (West 1990).

64. CAL. ADMIN. CODE tit. 11 §§ 1-2 (1984).

against the plaintiff.⁶⁵ Importantly, the attorney general controls the action at all times, and can at any stage of the proceeding withdraw, discontinue, or dismiss the action or assume the proceeding's management.⁶⁶

An expanded use of relator status based on the California approach would strengthen attorneys general's enforcement efforts, yet it would protect the charitable organization from frivolous suits brought by a member of the public. Who would seek to be relators? Public spirited citizens or public interest law firms, one would hope. This approach is already being used to deal with the backlog of drug cases in the State of Washington. Prosecutors have deputized volunteer attorneys from the private bar to serve as pro bono prosecutors. The presiding judge of King County Seattle has hired temporary judges.⁶⁷ One hindrance to significant expansion of enforcement through this approach is the question of attorney's fees for the successful relator. The defendant charitable organization or its directors are an obvious source, but they may not have the financial resources. However, the financial situation of many nonprofits would make this kind of litigation unattractive to the aggressive fee-seeking plaintiff's bar so active in the private sector.⁶⁸ A fund for the compensation of attorneys similar to those that exist in the criminal area might be created. The fund would be under the supervision of the

65. Id. at § 6.

66. Id. at § 8.

67. London, Volunteer Prosecutors End Backlog of Drug Cases, N.Y. Times, Aug. 24, 1990 at B6, col. 3. In England, senior barristers called Queens Counsel are regularly appointed to investigate and prosecute alleged statutory violations.

68. See, Coffee, Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working, 42 Md. L. Rev. 215 (1983).

attorney general. An expanded use of relators to enforce the responsibilities of charitable organizations to the public would provide an appropriate balance between more effective regulation of charitable activities and the protection of nonprofits from nuisance litigation.

III. SELF-REGULATION BY EXEMPT ORGANIZATION

One possible alternative to existing statutory approaches is self-regulation by professional associations of charitable solicitors and nonprofit organizations. Self-regulation is the agreement by a group of individuals or institutions that regulation of their activities is desirable in the common interest, and their acceptance that rules for the performance of functions and of duties should be established and enforced. A possible approach might be to create industry-wide bodies - for educational institutions, nonprofit hospitals, libraries, etc. These organizations might develop industry-wide codes of behavior for their members. The approach would be analogous to that which governs the securities industry. A federal charities board or commission could grant these regulatory bodies the authority to admit member charities to membership, develop rules of conduct, and discipline them for violations. Charitable solicitors might be members of a National Association of Charitable Solicitors, a self regulatory organization analogous to the National Association of Securities Dealers. A Federal Charities Board would monitor the effectiveness of industry self regulatory organizations.

The New York Stock Exchange until 1934 and the London Stock Exchange until 1986 were examples of self-regulation completely free from government oversight or

control. Regulation was based upon contract. Members of the exchange agreed to abide by rules promulgated by their fellow practitioners. The exchanges controlled admission of brokers, developed binding conduct of business rules, and disciplined their members. Wholly private self-regulation failed, because of the inability of the exchanges to control fraudulent activity by their members. The exchanges restricted competition and resisted or ignored changes in the economic environment. Both systems were replaced by mixed systems combining statutory mandates and self-regulation; that is, the self-regulatory framework was statutorily backed and practitioner based. While it is too soon to reach a verdict on London's new securities regulatory framework, over the last sixty years the Securities and Exchange Commission has had to exert increasing authority over the Exchanges to make self-regulation work.⁶⁹

A. ADVANTAGES OF SELF-REGULATION

There are several advantages to a self regulatory system over direct governmental control. One argument in favor of practitioner based self-regulation is that members of the affected industry can bring to bear their expertise, and in many cases expedition, not to be trusted of more remote civil servants. Informed practitioners are close to regulatory problems and may be better able to solve them. They know the texture of the regulated area as well as the limits, costs, and potential of regulation. A special study of the securities markets by the Securities and Exchange Commission in 1963 addressed the advantages of industry expertise:

69. See, Lipton, The SEC or the Exchanges: Who Should Do What and When? A Proposal to Allocate Regulatory Responsibility for Securities Markets, 16 U. Calif. Davis L. Rev. 527, 528-529 (1983). [hereinafter Lipton].

The expectations and immediacy of self-regulation often provide the most expedient and practical means for regulation, by making those regulated actual participants in the regulatory process they become more aware of the goals of regulation and their own stake in it.⁷⁰

Practitioner based regulation is more likely to receive the support of the regulated, because the regulators are assumed to know and sympathize with industry problems. Industry experts surely are more responsive to industry needs than governmental regulators, who have several goals, of which the economic health of the industry or sector is but one. Government's primary regulatory responsibility is protection of the public through rulemaking and prosecution of violators.

Self-regulation by sector practitioners can be more inclusive and reach into more minute areas of conduct, because sector experts can be deployed more efficiently. Expertise, however, can be used to thwart regulation if the self-regulatory organization is merely a trade group. Sector experts can more easily resist effective regulation by government. Insulating the industry from government may lessen needed external supervision and control. On the contrary, self-regulation allows the government to deny responsibility for control it may or may not in fact exercise.⁷¹ Self-regulation may remove some of the tensions between government agencies and industry.⁷²

One of the more attractive arguments in favor of a self-regulatory system is that it

70. Cf. SEC, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H. R. Doc. 95, 88th Cong. 1st Sess. pt. 4 at 722. [hereinafter SPECIAL STUDY].

71. Page, Self-Regulation: The Constitutional Dimension, 49 Mod. L. Rev. 141 (1986).

72. Miller, Self-Regulation of the Securities Markets: A Critical Examination, 42 Wash. & Lee L. Rev. 853, 858 (1985) [hereinafter Miller].

is less costly than direct regulation. To pour resources to adequately enforce the existing statutory regime governing charities would be enormously expensive with uncertain added benefit. A self-regulatory system's costs are borne by the regulated and ultimately by the beneficiaries of the charitable organizations' activities. Because a self-regulatory system is practitioner based, it is assumed regulators' expertise can be used to a cost efficient advantage. There is a common belief that government regulation requires a larger bureaucracy.

However, cost savings of self-regulatory systems are uncertain. Even more important than the direct costs are indirect costs of compliance. Because practitioner based systems may be more intrusive than direct regulation, they may increase the total cost of compliance. Even self-regulating organizations need professional bureaucracies. Because they are private organizations their members are likely to be paid the industry going-rate which may be higher than the comparable civil service salary.⁷³

What is probably true is that less direct governmental expenditure of regulating an industry arouses less controversy from the public or political interests. On the other hand, industry sources, who may not be able to pass all costs on to the public, may object to increases in expenditure even if the need is there.

Other advantages of a self-regulatory system are its flexibility and informality. Because it is based upon freely entered into contracts among its members, a self-regulatory system can amend its rules more easily without the necessities of public

73. Cf. Jennings, Self-Regulation in the Securities Industry: The Role of the Securities and Exchange Commission, 29 Law & Contemp.Problems, 663, 677 (1964) [hereinafter Jennings].

notice and other procedural steps. Flexibility permits self-regulators to react more quickly to changes in the economic environment than government regulation. Once a regulatory bureaucracy is in place, inflexibility develops. It is difficult to introduce change.⁷⁴

Informality allows punishment of violators to be meted out more quickly and quietly, and sometimes more efficiently. Due process is more formal and more expensive. Government prosecution, because of its due process strictures, requires time, hearings, and appeals. There is a tension between the need for fairness and process and the advantages of flexibility and informality.

A self-regulatory system can better address the ethical practices of an industry than governmental regulation, which by nature proceeds through law and rulemaking to determine legal conduct. It may be impossible for government to regulate the voluntary sector's morals. Legal rules by definition determine the minimum parameters of conduct.

Self-regulation would provide voluntary sector members with the incentive to cooperate, to develop shared norms for the common good of the industry, and to aspire to higher ethical behavior. Norms and rules developed by practitioners may be more psychologically acceptable to industry. The responsibility of participating in a system of self-regulation produces greater professional integrity and discipline and is more likely to render voluntary obedience.

In sheltered, smaller industries where regulators and members are known to one

74. Cf. S. HAYES, WALL STREET & REGULATION 187 (1987).

another, the fear of sanctions for violating ethical norms is an effective deterrent, but in the large anonymous nonprofit sector self-regulators might be as distant as government civil servants. The ethical and aspirational advantages of self-regulatory systems may not hold if the community is too diverse.

Direct government regulation is more often confrontational whereas self-regulation is cooperative because regulators, industry and the government share common goals of investor protection and industry prosperity.⁷⁵ Self-regulatory organizations can mediate between the concerns of government, other interests that desire greater regulation, and the needs of the voluntary sector to be free from excessive fetters. Practitioner based regulation can bring together disparate interests and constituencies to solve common problems and attain common goals.⁷⁶

William O. Douglas, when Chairman of the Securities and Exchange Commission, said: "Self-discipline is always more welcome than discipline imposed from above." He added:

From the broad public viewpoint, self-regulation can be far more effective [than direct regulation]...Self-regulation...can be pervasive and subtle in its conditioning influence over business practices and business morality. By and large, government can operate satisfactorily only by proscription. That leaves untouched large areas of conduct and activity; some of it susceptible of government regulation but in fact too minute for satisfactory control; some of it lying beyond the periphery of the law in the realm of ethics and morality. Into these large areas self-government, and self-government alone, can effectively reach. For these reasons such self-regulation is by far the preferable course from

75. Miller, supra note 72 at 859, n. 24.

76. Karmel, Securities Industry Regulation - Tested by the Crash, 45 Wash. & Lee, 1297, 1299 (1988) [hereinafter Karmel].

all viewpoints.⁷⁷

B. PROBLEMS WITH SELF-REGULATION

Industry self-regulating organizations have a number of conflicting roles. They are expected to set standards and discipline their members so that the public will be protected. Private self-regulating organizations thereby serve a public purpose and in fact, assume public and governmental responsibilities. Their power to set standards and to mandate how business is conducted, to discipline, restrict entry and expel, is in practice a delegation of state power to private bodies. This can lead to abuses of authority violative of due process.⁷⁸ Self-regulating organizations have a governmental aura without governmental accountability.⁷⁹ They have been analogized to quasi-public utilities in regard to their relation to the general public and thus require public oversight for many of the same reasons that railroads, power companies or telephone companies do.⁸⁰

A totally private regulatory framework has little accountability to the public. Pressures for public accountability led to an increased governmental role in the regulatory process in the financial services area. In addition, self-regulating

77. Address Before the Bond Club of Hartford, Connecticut, quoted by Jennings, supra note 73 at 678.

78. See Lowenfels, A Lack of Fair Procedures in the Administrative Process: Disciplining Proceedings at the Stock Exchange and the NASD, by Cornell L. Rev. 375 (1979) but see Poser, Reply to Lowenfels, 64 Cornell L. Rev. 402 (1979).

79. Karmel, supra note 76 at 1299.

80. SPECIAL STUDY, supra note 70 pt 4 at 502.

organizations have divided loyalties. As membership organizations, they have promotional responsibilities and function as mere trade associations. Inevitably, the pull of membership will overshadow loyalty and responsibility to the public.

It may be difficult for a self-regulatory organization to discipline its membership, particularly if the member is part of the industry establishment as opposed to a fringe operator. The most cited example, is the defalcations in the 1930s of Richard Whitney, President of the New York Stock Exchange, and the bankruptcy of his firm which were known by many members of the Exchange years before the scandal broke, yet nothing was done.⁸¹

Almost all self-regulatory systems eventually require increasing governmental oversight. The correct balance between self and direct regulation is difficult to achieve. Left to themselves many SROs will tilt toward their trade association functions. There is a limit to the deregulatory vision in that it does not respond to the way that SRO members act. The history of self-regulatory systems in the United States has been of ongoing resistance to rigorous enforcement in the absence of governmental pressure.

Self-regulatory organizations have strong anti-competitive tendencies because at bottom they are trade associations. SROs' regulation of their members' activities are essentially economic decisions.⁸² Non-traditional charities may feel the brunt of industry regulation. Within self-regulatory organizations there often develops interest group conflicts in which the dominant elements promote their policies to the detriment

81. III. L. LOSS & J. SELIGMAN, *SECURITIES REGULATION* (3rd ed. 1990).

82. Miller, *supra* note 72 at 867.

of membership and the public. Competition may arise between differing SROs who may seek to expand their regulatory turf in the nonprofit sector, to give its members an edge in attracting the charitable dollar.

It is difficult for SROs to avoid conflicts of interest in dealing with their members. The first criticism of self-regulation is that of insufficient zeal. The Special Study on the Securities Industry noted:

No business is eager for regulation ... and it is only natural to expect less zeal for almost any aspect of the job on the part of a self-regulator than may be true of an outsider whose own business is not involved. To the extent that there are matters of degree the self-regulator, absent governmental oversight, is generally and understandably motivated by self-interest to lean toward the lesser degree.⁸³

Almost by definition, a self-regulatory organization is captured by the industry it oversees. When issues arise the instinctive response is less regulation rather than more and allow the industry work out the problem. The cheapest alternative often turns out to be the most favored despite the impact upon public. Accompanying the general disinclination to regulate is resistance by members to regulation promulgated by their SRO.

Because of self-interested behavior, and the inability to enforce rules violations, self-regulatory systems give way to direct or mixed systems. The theory of self-regulation posits that the direct agency asserts its reserve power only if the SROs initial exercise of authority is inadequate. This view, however, is inaccurate. The American experience has been that the Securities and Exchange Commission not only has had to play more than

83. SPECIAL STUDY, *supra* note 70, pt. 4 at 696.

this residual role, but has continually needed to expand its authority over American self-regulating organizations.⁸⁴ Because the drift to self-interest is so strong, even in a mixed direct self-regulating scheme, the government agency must play an assertive initiatory role.

Self-regulation which is not backed by federal statutory authority and a federal supervising agency offers little promise for effective and efficient regulation of the nonprofit sector. One reason is that of scale. The securities industry's base of self-regulation is the exchange, which has a discrete and discernible membership. There is also a supervising web of federal and state legislation that makes the scale of unregistered securities risky and difficult. There is a greater net of relationships between financial services firms than exists in the charitable sector. Also, there is overlap and coordination between the self-regulating organizations.

The fundamental difficulty in establishing a workable self-regulating system in the voluntary sector is that there are just too many charitable organizations seeking the public's dollars. The current difficulties of registration and monitoring of state efforts would be transferred to self-regulating organizations, which would have less of an interest in rigorous enforcement than direct governmental control. Established organizations would adhere to the rules of the SROs, but the thousands of fringe groups would ignore or evade the SRO model.

84. Lipton, supra note 69 at 528-29.

The concept of a federal charities commission is not new.⁸⁵ However, we live in an age of deregulation. Politically it is not realistic to assume that such a new agency would be established.

A federally backed self-regulating system might be more expensive than a properly funded state regulatory regime. While governmental costs might be less, the SROs would need experienced staff and the capabilities to enforce their rules. The indirect costs to charities and charitable solicitors might be greater than the costs under the existing system, as self-regulation implies that costs are paid by members' dues. The costs of compliance would be greater as there would undoubtedly be federal filing requirements in addition to those mandated by the SRO. State regulation would not wither away. Self-regulation backed by federal legislation would create additional layers of supervision. Self-regulation often leads to duplication.

A self-regulatory system without governmental oversight just would not work as the nonprofit sector is too diffuse, and sanctions could be difficult and expensive to employ. At one time stock exchanges in the U.S. and England could effectively operate on a private self-regulatory basis because they were first and foremost cartels, relatively small in size, and most importantly, had shared values about what they did, and the need to self regulate themselves. The fear of government intrusion was strong enough to make self-regulation work, but alternatively it failed because some members would not abide by the rules or the SROs did not enforce them with rigor.

85. See Karst, The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility, 73 Harv. L. Rev. 433, 476-83 (1960).

This is not to suggest that industry organizations do not have a role in improving the fundraising behavior of non profit organizations. The nonprofit sector should continue to establish standards for solicitation and qualifications of fundraising counsel. Perhaps the most important thing industry associations could do is to educate the public as to what to ask solicitors and what to do if the response is not forthcoming or is later found to be inaccurate.

None of the new approaches to the regulation of charitable solicitation - broadened standing, increased use of relators, or a self regulatory framework modeled on the securities industry will curb the abuses that exist. At least they will sensitize the public. In the last analysis an informed and inquiring donor is the best protection against charitable fraud.