

THE LEGAL CHALLENGES POSED BY
SOCIAL MEDIA VIRAL CAMPAIGNS, CROWDFUNDING, AND HYBRID ENTITIES

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The ALS Ice Bucket Challenge raised \$115 million in eight weeks to help find a treatment for Lou Gehrig’s disease.¹ After a six-day crowdfunding campaign brought in more than \$67,000, the city of Detroit hopes to have a new, privately funded statute – of RoboCop.² Hundreds of new "social enterprises" formed as benefit corporations, social purpose corporations, or other types of hybrid entities combine profitmaking with social missions, and prominent existing businesses such as Kickstarter and Patagonia have converted to a hybrid form.³

These innovative ways of generating financial support for doing good are rightly applauded. But at the same time they present a challenge to federal and state regulators who generally oversee the raising of funds for charitable purposes. An important threshold issue for these regulators is whether their existing statutory authority reaches these new ways of seeking support for charitable organizations and causes and, if not, whether it should. This short paper first briefly summarizes the applicable law and then identifies the key questions that need to be answered with respect to each of these new ways of raising funds to support charitable efforts.

Legal Background

Most states have laws relating to the oversight of charitable solicitation, usually focusing on registration and reporting requirements for the charitable organizations involved and those who assist them in such activities.⁴ The other entities that may be covered by these laws usually include “professional solicitors” or “professional fundraisers,” “fundraising counsel,” and “commercial co-venturers.” Definitions vary from state to state, but generally these categories are defined along these lines: “[p]rofessional fundraisers are individuals or entities paid to solicit funds on behalf of a charity; fundraising counsels are individuals or entities paid to advise or assist with the

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¹ ALS ICE BUCKET CHALLENGE, <http://www.alsa.org/fight-als/ice-bucket-challenge.html>? (last visited Feb. 17, 2017).

² Julie Hinds, *RoboCop Statue Team Reveals That Bronze Pieces Finally Coming Together*, DETROIT FREE PRESS, Feb. 10, 2017; Sara Malm, *Giant Bronze RoboCop Statue To Be Unveiled in Detroit After Crowdfunding Raises \$67,000 in Six Days*, DAILY MAIL, Sept. 26, 2013.

³ See Ellen Berrey, *How Many Benefit Corporations Are There?* (2015), https://papers.ssrn.com/sol3/papers2.cfm?abstract_id=2602781; Alicia E. Plerhoples, *Delaware Public Benefit Corporations 90 Days Out: Who’s Opting In?*, 14 U.C. DAVIS BUS. L.J. 247 (2013); Mike Isaac & David Gelles, *Kickstarter Focuses Its Mission on Altruism Over Profit*, N.Y. TIMES, Sept. 21, 2015, at B1; John Tozzi, *Patagonia Road Tests New Sustainability Legal Status*, BLOOMBERG (Jan. 4, 2012, 7:57 AM ET), <http://www.bloomberg.com/news/2012-01-04/patagonia-road-tests-new-sustainability-legal-status.html>.

⁴ IRS, CHARITABLE SOLICITATION – STATE REQUIREMENTS, <https://www.irs.gov/charities-non-profits/charitable-organizations/charitable-solicitation-state-requirements> (last visited Feb. 17, 2017).

solicitation of contributions on behalf of a charity, but do not solicit or have custody of funds; and commercial co-venturers are entities that advertise that the purchase or use of any goods, services, entertainment, etc. will benefit a charitable organization or purpose.”⁵

While it is clear that states have jurisdiction to apply these laws to charities domiciled in their state or that actively solicit donations in their state, the Internet has created some uncertainty as to when a state has jurisdiction over a charity that is domiciled outside of the state. As a matter of constitutionally required due process, states must apply a minimum contacts standard to determine if a state has such jurisdiction. The Charleston Principles issued in 2001 by the National Association of State Charity Officials (NASCO) “represent the states’ effort to consistently apply minimum contacts principles to the existing state charitable solicitation regulatory framework.”⁶ More specifically, the Principles provide that state charitable solicitation laws only apply to entities that are domiciled within the state, entities that are domiciled outside the state if their non-Internet activities would require registration in the state, and entities that are domiciled outside the state if they solicit through an interactive or non-interactive Web site and either specifically target persons physically located in the state, or receive contributions from the state on a repeated and ongoing basis or a substantial basis through or in response to the Web site solicitation.⁷ While the Principles are only guidelines, NASCO encourages their use in applying a state’s laws.⁸ As for fundraising platforms and social media sites, at least one attorney general has issued guidelines indicating that the application of existing laws to such for-profit companies will simply depend on whether they fall within the state’s existing definition of commercial fundraiser, fundraising counsel, or commercial co-venturer.⁹

At the federal level, the Federal Trade Commission (FTC) only has jurisdiction over entities organized for profit; as a result the FTC is not able to directly regulate charitable nonprofit organizations.¹⁰ It is, however, able to regulate for-profit entities that assist charities with respect to their fundraising activities, including for-profit entities that state law classifies as professional solicitors or professional fundraisers, fundraising counsel, or commercial co-venturers. In addition, if a purported charity is actual a sham the

⁵ Karen Wu, *A Moving Target: The Regulation of Online Fundraising Platforms*, NONPROFIT TIMES, Mar. 13, 2015, <http://www.thenonproffitimes.com/news-articles/a-moving-target-the-regulation-of-online-fundraising-platforms/>.

⁶ Wu, *supra* note 5; see NASCO, *The Charleston Principles: Guidelines on Charitable Solicitations on the Internet* (Mar. 14, 2001), <http://www.nasconet.org/wp-content/uploads/2011/05/Charleston-Principles-Final.pdf>.

⁷ NASCO, *supra* note 6, Principle III(A), (B)(1).

⁸ Wu, *supra* note 5

⁹ Kamala D. Harris: Attorney General, State of California, *Crowdfunding & Nonprofits: The California Attorney General’s Guide for Crowdfunding Sites, Charities, and Donors*, 2 available at <https://oag.ca.gov/sites/all/files/agweb/pdfs/charities/publications/crowdfunding.pdf>.

¹⁰ James J. Fishman, *Who Can Regulate Fraudulent Charitable Solicitation?*, 13 PITT TAX REV. 1, 34 (2015).

organization is no longer considered a nonprofit organization and therefore the FTC is able to reach that entity.¹¹

At both the state and federal level, consideration also has to be given to the fact that charitable solicitations are fully protected speech under the First Amendment. This protection even extends to when the solicitation is “conducted by a professional fund raiser with a profit motive.”¹² At the same time, “[t]he First Amendment . . . does not shield fraud. Like other forms of public deception, fraudulent charitable solicitation is unprotected speech.”¹³ The government has a legitimate interest in protecting the public from fraud and therefore they can “vigorously enforce their antifraud laws,” including with respect to charitable solicitations.¹⁴

Social Media Viral Campaigns

The 2014 ALS Ice Bucket Challenge is the poster child for a successful social media viral campaign to generate support for a charitable organization. Started by individuals interested in supporting ALS and then spread through social media channels to the family, friends, and acquaintances, the Challenge is credited with generating \$115 million in donations.¹⁵ At the same time, because the individuals involved were acting independently from ALS and without compensation, and because all donated funds went directly to ALS and not to any intermediaries, it appears that the activities of these individuals likely did not trigger any reporting, registration, or other requirements under existing state charitable solicitation laws or make them subject to FTC jurisdiction.

For a well-known and national charity such as ALS that was presumably already in compliance with all state and federal regulatory requirements relating to soliciting charitable contributions, this lack of regulatory oversight did not appear to raise any significant concerns (although there was criticism of ALS’ attempt to trademark the phrase “Ice Bucket Challenge” and some more general worries about it distorting giving priorities).¹⁶ The success of the campaign and therefore the strong likelihood that others will seek to reproduce it does, however, create the possibility of a different scenario developing. For example, what if the identified charitable organization is a small, local charity that had previously only solicited and received donations from residents of a single state? A successful viral campaign could lead to a surge in donations from across the country, but likely with no obligation on the part of the charity to register, report, or otherwise comply with other state’s charitable solicitation laws (at least until the charity begins asking these new donors for additional contributions). Or what if the named entity is actual a sham, created by unscrupulous individuals to briefly ride the success of the

¹¹ *Id.*

¹² Seth Perlman, *State and Federal Regulation of Charitable Solicitations*, in *ADVISING NONPROFIT ORGANIZATIONS* 355, 366 (Pamela A. Mann ed., 2009).

¹³ *Illinois ex. rel. Madigan v. Telemarketing Assoc., Inc.*, 538 U.S. 600, 601 (2003).

¹⁴ Perlman, *supra* note 12.

¹⁵ *See supra* note 1

¹⁶ *See* Thomas Boni, *Editor’s Desk: A Closer Look at the ALS Ice Bucket Challenge*, *CRESTVIEW NEWS BULL.*, Sept. 3, 2014; Abby Ohlheiser, *ALS Association Withdraws Controversial Applications to Trademark “Ice Bucket Challenge,”* *WASH. POST*, Aug. 30, 2014.

viral campaign and then to disappear (with the donated funds)? Does the extent of charitable solicitation laws or the reach of the FTC need to be adjusted to provide for scenarios such as the latter two ones?

More specifically, key questions to be answered include:

- Do state charitable solicitation laws and federal laws enforced by the FTC not apply to individuals who solicit contributions for a charitable organizations if such individuals operate independently of the charity involved, do not receive compensation, and do not receive any portion of the donated funds themselves? If so, are there any circumstances under which such individuals should be subject to such laws?
- Are there any circumstances under which social media sites that individuals use to promote such viral campaigns could be or should be considered professional solicitors, fundraising counsel, or commercial co-venturers and so subject to the state law obligations of such entities?
- Do state charitable solicitation laws only apply to the beneficiary of a social media viral campaign to the extent the charity itself operates in or requests donations from individuals in a given state, as opposed to simply receiving donations from individuals in a given state in response to the viral campaign? If so, are there any circumstances under which such charities should be subject to such laws of a particular state if the only connection of the charity to that state is donation of funds from residents of that state in response to a viral campaign?

Crowdfunding

Crowdfunding has great potential for supporting charitable causes, with some crowdfunding sites even creating dedicated portals for such purposes.¹⁷ Such efforts include both appeals for funds to support specific, identified charitable organizations and appears for funds to support specific activities or causes that appear to be "charitable" in a non-legal sense but are not connected to an identified charitable organization. For example, the first page of one such site includes both an appeal to support a specific charitable organization (and specifically notes that donations would be tax-deductible) and an appeal to help a specific individual suffering from a rare illness (with no mention of any charitable organization being involved).¹⁸ The type of appeal matters, as indicated by the fact that at least one state has stated that an appeal for a specific individual is outside the scope of that state's charitable solicitation law.¹⁹ But when a crowdfunding effort is tied to a specific charity, it raises the question of whether current state charitable

¹⁷ See, e.g., GENEROSITY BY INDIEGOGO, <https://www.generosity.com/> (last visited Feb. 17, 2017).

¹⁸ See Join Rose to Fight Force Labor Slavery!, <https://www.generosity.com/volunteer-fundraising/join-rose-to-fight-forced-labor-slavery> (raising funds for the International Justice Mission) (last visited Feb. 17, 2017); Save a Young Girl's Life, <https://www.generosity.com/emergencies-fundraising/save-a-young-girl-s-life> (last visited Feb. 17, 2017).

¹⁹ See State of Michigan Attorney General Bill Schuette, Crowdfunding for Donations, http://www.michigan.gov/ag/0,4534,7-164-17337_20942-323428--,00.html (last visited Feb. 17, 2017).

solicitation laws and federal laws administered by the FTC reach that effort and those involved with it.

More specifically, key questions raised by such crowdfunding include:

- Are there any circumstances under which the users who start such crowdfunding efforts are or should be subject to state charitable solicitation laws or the federal laws administered by the FTC? For example, if the user receives a portion of the funds received would they be considered a professional fundraiser for purposes of the state charitable solicitation laws that impose certain obligations on such persons?
- Are there any circumstances under which the operators of a crowdfunding site that hosts such efforts are or should be subject to such laws? As noted above, at least one attorney general has provided helpful guidance on when its existing commercial fundraiser, fundraising consultant, and co-venturers laws reach crowdfunding site operators, but such guidance does not address whether the reach of those laws should be increased or decreased in this context.
- Are there any circumstances under which the benefitting charitable organizations can or should be subject to such laws as a result of such crowdfunding efforts? For example, what if the charity is itself the user that launches the crowdfunding effort?

Hybrid Entities

The enactment of state laws authorizing the creation of benefit corporations, low-profit limited liability companies (L3Cs), public benefit corporations, social purpose corporations and other legal forms designed to permit a for-profit business to pursue both profits and a social or public benefitting mission presents a different set of questions. Such entities do not solicit donations for charitable purposes nor do they hold assets for charitable use and so they do not generally fall within the scope of state charitable solicitation statutes or the authority of state officials to oversee the use of charitable assets.²⁰ (The one exception may be the L3C, as at least one state by statute requires L3Cs and their primary manager to register with the attorney general.²¹) They do, however, often tout their social or public benefitting mission in order to attract both investors and customers. Accurate and complete disclosure of information to potential and current investors is generally the province of federal and state securities laws and so beyond the scope of this piece. There is, however, at least one key question relating to state charitable solicitation laws and federal laws administered by the FTC:

- If a hybrid entity touts its social or public benefitting mission to attract customers, to what extent does the entity's pursuit of that mission (that is the, the truthfulness of its claims regarding that mission) become subject state or federal (FTC)

²⁰ See MODEL PROTECTION OF CHARITABLE ASSETS ACT (2011).

²¹ See 805 ILL. COMP. STAT. 180/1-26(d) (2010).

consumer protection oversight? For example, such claims violate state laws prohibiting deceptive trade practices if a hybrid entity fails to sufficiently pursue its advertised social mission?

Conclusion

The development of innovative new methods for attracting public support for charitable organizations and charitable efforts presents a challenge to existing state and federal laws primarily designed in a pre-Internet and pre-hybrid entity era. In some instances the existing laws may reach those individuals and entities involved in deploying these new methods. In other instances, they may not. In both situations consideration needs to be given whether and to what extent these laws should apply, balancing the need to protect the public against the risk of unduly burdening these methods for supporting support good works. This piece represents an early attempt to identify the specific potential applications that need to be addressed to strike this balance appropriately.