No. 01-1806

In the Supreme Court of the United States

JAMES E. RYAN, ATTORNEY GENERAL OF ILLINOIS,
PETITIONER

v.

TELEMARKETING ASSOCIATES, INC., ET AL.

ON WRIT OF CERTIORARI TO
THE SUPREME COURT OF ILLINOIS

BRIEF FOR THE UNITED STATES AND THE FEDERAL TRADE COMMISSION AS AMICI CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Whether the First Amendment precludes a State from pursuing a fraud action against a professional fundraiser who intentionally misleads potential donors by misrepresenting how charitable donations will be used.

TABLE OF CONTENTS

	Page
Interest of the United States and the Federal Trade Commission	1
Statement	2
Summary of argument	6
Argument:	
The First Amendment permits fraud actions against professional fundraisers who intentionally mislead potential donors by misrepresenting how charitable contributions will be used	10
A. Fraudulent speech, including fraudulent charitable solicitation, is not protected by the First Amendment	12
B. Fraudulent charitable solicitation frequently involves misrepresentations about how contributions will be used	15
C. This Court's precedents do not preclude fraud actions based on misrepresentations that a significant portion of donations will be spent on particular charitable purposes	18
D. Nothing in *Riley* precludes fraud claims based on implied misrepresentations about how charitable donations will be used	23
Conclusion	29

TABLE OF AUTHORITIES

Cases:

Bose Corp. v. *Consumers Union of the United States, Inc.*, 466 U.S. 485 (1984)	14
Cantwell v. *Connecticut*, 310 U.S. 296 (1940)	13
Chaplinsky v. *New Hampshire*, 315 U.S. 568 (1942)	12, 13

Cases—Continued: Page

Donaldson v. *Read Magazine*, 333 U.S. 178 (1948) 12, 13
FTC v. *Gold*, No. CV-99-2895-CBM (C.D. Cal. Nov. 6, 2000) 16
Freedman v. *Maryland*, 380 U.S. 51 (1965) 27
Gertz v. *Robert Welch, Inc.*, 418 U.S. 323 (1974), cert. denied, 459 U.S. 1226 (1983) 13
Hays v. *Meyers*, 107 S.W. 287 (Ky. 1908) 23
Hofmann v. *Hofmann*, 446 N.E.2d 499 (Ill. 1983) 14
Hustler Magazine v. *Falwell*, 485 U.S. 46 (1988) 13
Kraft, Inc. v. *FTC*, 970 F.2d 311 (7th Cir. 1992), cert. denied, 507 U.S. 909 (1993) 28
Masson v. *New Yorker Magazine, Inc.*, 501 U.S. 496 (1991), aff'd, 85 F.3d 1394 (9th Cir. 1996) 28
Milkovich v. *Lorain Journal Co.*, 497 U.S. 1 (1990) 28
New York Times Co. v. *Sullivan*, 376 U.S. 254 (1964) 7, 14
People v. *Orange County Charitable Servs.*, 87 Cal. Rptr.2d 253 (Ct. App. 1999) 17
People ex rel. Chicago Bar Ass'n v. *Gilmore*, 177 N.E. 710 (Ill. 1931) 11
Removatron Int'l Corp. v. *FTC*, 884 F.2d 1489 (1st Cir. 1989) 11
Riley v. *National Fed'n of the Blind of N.C., Inc.*, 487 U.S. 781 (1988) 5, 19, 20, 21, 24, 25, 26
Schneider v. *State*, 308 U.S. 147 (1939) 7, 13
Secretary of State v. *Joseph H. Munson, Co.*, 467 U.S. 947 (1984) 5, 19, 20, 21
Smith v. *Chadwick*, 9 App. Cas. 187 (1884) 26
Smith v. *Daily Mail Publ'g Co.*, 443 U.S. 97 (1979) 27
Speiser v. *Randall*, 357 U.S. 513 (1958) 27
Stewart v. *Wyoming Cattle Ranche Co.*, 128 U.S. 383 (1888) 9, 10, 23, 25

Cases—Continued: Page

United States v. *Cherna*, 184 F.3d 403 (5th Cir. 1999), cert. denied, 529 U.S. 1065 (2002) 16
United States v. *Ciccone*, 219 F.3d 1078 (9th Cir. 2000) 16
United States v. *Gold*, No. SACR 01-150 DOC (C.D. Cal. Feb. 25, 2002) 17
United States v. *Kinney*, 211 F.3d 13 (2d Cir. 2000) 17
Village of Schaumburg v. *Citizens for a Better Env't*, 444 U.S. 620 (1980) 5, 19, 20, 21, 27
Watchtower Bible & Tract Soc'y of New York, Inc., v. *Village of Stratton*, 536 U.S. 150 (2002) 12
Witt, In re, 583 N.E.2d 526 (Ill. 1991) 11

Constitution, statutes, regulations and rule:

U.S. Const. Amend. I ..... *passim*
Federal Trade Commission Act, § 5, 15 U.S.C. 45 2
Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. 6101 *et seq.*:
15 U.S.C. 6102 2
15 U.S.C. 6106(4) 2
USA Patriot Act, Pub. L. No. 107-56, 115 Stat. 396:
§ 1011(b)(3), 115 Stat. 396 2
§ 1011(d), 115 Stat. 396 1
18 U.S.C. 1341 1
18 U.S.C. 1343 1
18 U.S.C. 2325 1
18 U.S.C. 2326 1
225 Ill. Comp. Stat. Ann. 460/1 (West 1998) (Illinois Solicitation for Charity Act) 3
815 Ill. Comp. Stat. Ann. (West 1999):
§ 505/1 (Consumer Fraud and Deceptive Business Practices) 3
§ 505/2 11
§ 510/1 (Uniform Deceptive Trade Practices Act) 3

Regulations and rule—Continued: Page

16 C.F.R. 310.3(d)(3) 2
16 C.F.R. 310.3(d)(4) 2
Fed. R. Civ. P. 9(b) 14

Miscellaneous:

Better Business Bureau Wise Giving Alliance, *Donor Expectations Survey* (Oct. 17, 2001) <http://www.give.org/news/Donor%20Expectations%20-survey.pfd> 22
Developments in the Law—Nonprofit Corporations, 105 Harv. L. Rev. 1578 (1992) 12
W. Page Keeton, *Prosser and Keeton on The Law of Torts* (5th ed. Hornbook Series Law. ed. 1984) 28
Restatement (Second) of Torts (1977) 10, 14, 25

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INTEREST OF THE UNITED STATES AND THE FEDERAL TRADE COMMISSION

This case concerns the extent to which the First Amendment limits the government's authority to curtail fraudulent solicitations of charitable contributions. The United States has a substantial interest in that issue. The United States prosecutes fraudulent charitable solicitation under its criminal antifraud statutes. See, *e.g.*, 18 U.S.C. 1341 (mail fraud); 18 U.S.C. 1343 (wire fraud). Defendants convicted of those offenses in connection with telemarketing to solicit charitable donations are subject to enhanced penalties. See 18 U.S.C. 2325 (as amended by Pub. L. No. 107-56, § 1011(d), 115 Stat. 396); 18 U.S.C. 2326. The Federal Trade Commission (FTC) seeks civil redress for fraudulent charitable

fundraising under the FTC Act, 15 U.S.C. 45, which prohibits "unfair or deceptive acts or practices in or affecting commerce," and the Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. 6102, which requires the FTC to prescribe rules prohibiting deceptive or abusive telemarketing acts or practices, including those involving charitable solicitation. 15 U.S.C. 6106(4) (as amended by Pub. L. No. 107-56, § 1011(b)(3), 115 Stat. 396). Those rules prohibit the misrepresentation "directly or indirectly" of "the purpose for which any charitable contribution will be used" or "the percentage or amount of any charitable contribution that will go to a charitable organization or to any particular charitable program after any administrative or fundraising expenses are deducted." 16 C.F.R. 310.3(d)(3) and (4) (approved Dec. 13, 2002) *available at* <http://www.ftc.gov/os/ 2002/12/tsrfinal rule.pdf>.

STATEMENT

1. Respondents Telemarketing Associates, Inc., and Armet, Inc., are professional, for-profit fundraising corporations incorporated in Illinois. Amended Complaint (Am. Compl.) ¶¶ 2, 5, 22, 24. Respondents were retained by VietNow National Headquarters (VietNow), a charitable non-profit corporation, to solicit charitable contributions to aid Vietnam veterans. *Id.* ¶¶ 8-10. Their agreements with VietNow provided that respondents would retain 85% of the gross receipts from donors within Illinois, leaving VietNow with 15%. *Id.* ¶ 11, Group Exh. B. Respondents also brokered fundraising contracts between VietNow and third-party fundraisers in other States, under which those third parties retained 70% to 80% of gross receipts from donors outside of Illinois, respondents received 10% to 20% as a "finder" fee, and VietNow received 10%. *Id.* ¶ 12, Group Exh. C. Between 1987 and 1995, respondents collected $7.1 million from persons wishing to support VietNow's charitable activities and distributed approximately $1.1 million

(slightly less than 15%) to VietNow. *Id.* ¶¶ 10, 48. VietNow allegedly spent only about three percent of the gross amounts collected by respondents to provide charitable services to veterans. Pet. 2 & n.1.

In 1991, the Attorney General of Illinois filed a state court lawsuit against respondents that asserts common law and statutory claims for fraud and breach of fiduciary duty. Pet. App. 3-4.[1] Among other things, the amended complaint alleges that respondents engaged in fraud by intentionally misleading potential donors about the uses to which their donations would be put. More specifically, the complaint alleges that respondents "made telephone solicitations on behalf of Vietnow" in which they "represent[ed] to members of the public that the funds donated would go to further Vietnow's charitable purposes." Am. Compl. ¶ 29; see *id.* ¶ 63. Donors were told contributions would be used to help Vietnam War and other veterans, including the homeless and those suffering from combat-related injuries and illnesses.[2] They were specifically told contributions would be used to provide direct assistance, including job training, rehabilitation, food, and assistance with rent and other bills.[3]

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[1] In addition to common law fraud and breach of fiduciary duty, the amended complaint alleges violations of the Illinois Solicitation for Charity Act (formerly the Charitable Solicitation Act), 225 Ill. Comp. Stat. Ann. 460/1 (West 1998); the Consumer Fraud and Deceptive Business Practices Act, 815 Ill. Comp. Stat. Ann. 505/1 (West 1999); and the Uniform Deceptive Trade Practices Act, 815 Ill. Comp. Stat. Ann. 510/1 (West 1999). See Am. Compl. ¶¶ 1, 23, 51-52, 56, 58-59, 76.

[2] See, *e.g.*, Am. Compl. Group Exh. H at C000327 ("Vietnam veterans in need"); *id.* at C000332 ("Vietnam veterans who were injured"); *id.* at C000333 ("Vietnam vets suffering from 'Agent Orange' "); *id.* at C000336 ("other veterans such as the homeless").

[3] See, *e.g.*, Am. Compl. Group Exh. H at C000331 (contributions to be used for providing "support[,] both physical and mental[,] as well as legal matters"); *id.* at C000339 ("food baskets, bills and rent to help physically and mentally disabled Vietnam vets and their families"); *id.* at C000340

Written materials stated that "[a] substantial portion of the proceeds will be spent on the cost of the public awareness campaign and our program service," which was described as including "Agent Orange Victim Support," "Drug/Alcohol Treatment," and "Job Training." *Id.* ¶ 30, Exh. F. In at least one instance, a donor "specifically asked" what percentage of her contribution would be used for fundraising expenses "and was told 90% or more goes to the vets." *Id.* Group Exh. H at C000358.

The complaint further alleges that respondents "did not advise donors that the campaign was being conducted pursuant to private for-profit contracts whereunder a negligible amount, or only 15%, of all funds raised would be given to Vietnow and used for its charitable purpose." Am. Compl. ¶ 37. One donor was told that her donation would not be used for "labor expenses" because "all members are volunteers." *Id.* Group Exh. H at C000329.

Based on those allegations, the complaint charges that respondents "have engaged in a course and scheme of conduct whereby representations were made that a significant amount of each dollar donated would be paid over to Vietnow for its [charitable] purposes while in fact [respondents] knew that under the contracts 15 cents or less of each dollar would be available to Vietnow for its purposes." Am. Compl. ¶ 34. The complaint also charges that, because "the amount of funds being paid over to charity was merely incidental to the fund raising effort," respondents' representations "were knowingly deceptive and materially false and were made for the private pecuniary benefit of [respondents] and their agents." *Id.* ¶ 35. See *id.* ¶ 38.

(helping "Viet. vets in Du Page [County] find jobs [and] get on their feet"); *id.* at C000346 ("job training etc."); *id.* at C000355 ("food and homeless and general assistance"); *id.* at C000358 ("rehabilitation and other services for Vietnam vets").

The complaint alleges that respondents made those false representations with the purpose of inducing members of the public to make contributions that would be largely retained by respondents. Am. Compl. ¶¶ 35, 60, 77. The complaint further alleges that donors in fact relied on respondents' misrepresentations and that, had they known how much of their donations would go to profit respondents and how little would go to support VietNow's direct assistance programs, they would not have contributed. *Id.* ¶¶ 60, 64, 74, Group Exh. H.

2. Respondents filed a motion to dismiss the complaint in which they argued that the fraud claims against them were barred by the First Amendment. Pet. App. 3. The trial court granted the motion, and the Illinois Appellate Court affirmed the dismissal. *Id.* at 19-29. The Supreme Court of Illinois affirmed the judgment of the intermediate court. *Id.* at 1-17.

The Illinois Supreme Court sought guidance from a trilogy of this Court's decisions addressing the relationship between charitable fundraising and the First Amendment: *Village of Schaumberg* v. *Citizens for a Better Environment*, 444 U.S. 620 (1980), *Secretary of State* v. *Joseph H. Munson Co.*, 467 U.S. 947 (1984), and *Riley* v. *National Federation of the Blind for North Carolina, Inc.*, 487 U.S. 781 (1988). Those cases invalidated prophylactic state and local laws that categorically prohibited charitable organizations and professional fundraisers who retained high percentages of donated funds from engaging in charitable solicitation. See Pet. App. 6-11. In addition, *Riley* invalidated a related provision that imposed a duty on all professional fundraisers to disclose, at the outset of a fundraising appeal, the average percentage of receipts that they turned over to charities during the previous year. See 487 U.S. at 786 & n.3, 795-801.

The Illinois court concluded that "the Attorney General's complaint operates to limit [respondents'] ability to engage

in solicitation * * * in a manner found constitutionally impermissible by [this] Court in *Schaumberg*, *Munson*, and *Riley*." Pet. App. 13. The Illinois court recognized that the complaint alleges that respondents' representations about the intended use of donated funds were intentionally false. *Id.* at 12-13. The court reasoned, however, that, because the falsity of the representations depends on the fact that respondents retained 85% of gross receipts, the complaint "is, in essence, an attempt to regulate [respondents'] ability to engage in a protected activity based upon a percentage-rate limitation." *Id.* at 13. In the court's view, "[t]his is the same regulatory principle that was rejected in *Schaumberg*, *Munson*, and *Riley*." *Ibid.* The court further reasoned that, under *Riley*, "fraud cannot be defined in such a way that it places on solicitors the affirmative duty to disclose to potential donors, at the point of solicitation, the net proceeds to be returned to the charity." *Id.* at 15. Finally, the court reasoned that, if petitioner were allowed to pursue these fraud claims, "all fund-raisers in this state would have the burden of defending the reasonableness of their fees, on a case-by-case basis, whenever in the Attorney General's judgment the public was being deceived * * * because the fund-raiser's fee was too high"–a prospect that "could produce a substantial chilling effect on protected speech." *Id.* at 16. The court therefore held that "the Attorney General's complaint is prohibited under first amendment principles and was properly dismissed." *Id.* at 17.

SUMMARY OF ARGUMENT

The First Amendment does not preclude the government from prohibiting fraud or prosecuting those who intentionally deceive others for monetary gain. Intentional lies distort, rather than contribute to, the marketplace of ideas, and any value they have is outweighed by society's interest in protecting those harmed by deception. It has therefore been settled, for more than 60 years, that those who extract

money through fraudulent misrepresentations are not shielded by the First Amendment–even though their misrepresentations are speech and even if they solicit in the name of charitable causes. See, *e.g.*, *Schneider* v. *State*, 308 U.S. 147, 164 (1939).

The First Amendment and prohibitions on fraud have coexisted comfortably for more than 200 years not only because fraudulent speech is itself unprotected but because the essential elements of fraud also provide sufficient breathing room for legitimate speech, including charitable solicitation. Most significant, a fundraiser may not be held liable for fraud unless it is proven that he knew or believed that his representations were false or that he acted with reckless disregard for their truth or falsity. In the libel context, essentially the same standard has been held to provide sufficient breathing room for protected speech. *New York Times Co.* v. *Sullivan*, 376 U.S. 254, 280 (1964). In a fraud action, the government must also prove that the fundraiser intended for the donating public to rely on his misrepresentations and that donors' reliance was justifiable because the misrepresentations were material. Some jurisdictions also require that fraud be alleged with particularity or that it be proved by clear and convincing evidence. To the extent that additional protection for protected speech might be necessary, special procedural mechanisms, such as independent appellate review, could provide that protection without distorting or displacing the substantive state law of fraud.

The Illinois Supreme Court lost sight of the fact that the First Amendment and prohibitions on fraud are not inconsistent. Instead, that court mistakenly held that the First Amendment creates a special immunity for fundraisers who make fraudulent representations. But prohibitions on fraud always affect speech, and there is no reason for a special immunity in the charitable solicitation context. The State's

complaint alleges that respondents intentionally misled donors by creating the false impression that a significant amount of donated funds would go to direct assistance programs operated by VietNow. The complaint also alleges that respondents intentionally created a false impression that the fundraising effort was not being undertaken for profit. Those misrepresentations are typical of the charitable solicitation frauds that the federal government prosecutes both civilly and criminally. The government's cases have involved fundraisers who collected millions of dollars for charitable programs that received only a few thousand; who collected money in a charity's name when they intended to pay the charity a fixed amount regardless of how much they raised; and who formed charities for the very purpose of carrying out fraudulent solicitation. If affirmed by this Court, the ruling of the Illinois Supreme Court would seriously impair the government's ability to prosecute such frauds and thereby to protect and to promote legitimate charitable solicitation.

The state court mistakenly concluded that this Court's decisions in *Schaumberg*, *Munson*, and *Riley* somehow preclude fraud claims based on misrepresentations of the percentage of collected funds that will go to charity or of the particular charitable purposes on which donations will be spent. *Schaumberg*, *Munson*, and *Riley* invalidated state laws that categorically prohibited solicitation by charities or fundraisers who devoted a high percentage of funds raised to administrative or fundraising costs regardless of whether those solicitors were open, silent, or deceptive about the percentage that went to charitable purposes. Nothing in those cases suggests that a misrepresentation about the percentage of donations that will go to charity cannot be the basis for a fraud prosecution. The cases hold only that the government cannot rely on that percentage to obviate the need to prosecute and to prove actual fraud. The percentage

limitations in *Schaumberg*, *Munson*, and *Riley* violated the First Amendment because they prohibited perfectly truthful charitable solicitation when fundraising costs were judged too high. Here, respondents are free to solicit even if they retain a high percentage of contributions, provided they do not intentionally mislead donors about how contributions will be used.

The Illinois Supreme Court also erred in concluding that *Riley* precludes fraud claims based on implied misrepresentations about how charitable donations will be used. The law of fraud does not distinguish between one who intentionally misleads through explicit falsehoods and one who does so through half-truths or ambiguous statements that create a false impression. In each instance, both the speaker's goal and the effect are the same–to "purposely produce[] a false impression upon [the listener's] mind." *Stewart* v. *Wyoming Cattle Ranche Co.*, 128 U.S. 383, 390 (1888). It is the intent to deceive and the resulting deception that support liability for fraud. The same intent and the same result exclude fraudulent speech from the protections of the First Amendment.

Although this Court in *Riley* declared invalid a state law that required all professional fundraisers to disclose at the outset of any solicitation the percentage of funds actually remitted to charities in the previous year, Illinois fraud law does not impose such a prophylactic rule of compelled speech. Illinois law imposes not a duty to disclose but only a duty not to intentionally mislead. Fundraisers must disclose information only when their own representations would otherwise mislead the listener.

The Illinois court also erred in concluding that *Riley* suggests that fraud claims of this type will impermissibly chill protected speech. This Court was concerned about a possible chilling effect in *Riley* primarily because the fundraiser bore the burden of proving that his fee was rea-

sonable. Here, in contrast, the government bears the burden of proving that the fundraiser's representations were fraudulent. Moreover, although the potential for liability under the statute in *Riley* was likely to cause fundraisers to cease soliciting, the potential for fraud liability is only likely to cause them to provide more complete information. That result is wholly consonant with the First Amendment.

ARGUMENT

THE FIRST AMENDMENT PERMITS FRAUD ACTIONS AGAINST PROFESSIONAL FUNDRAISERS WHO INTENTIONALLY MISLEAD POTENTIAL DONORS BY MISREPRESENTING HOW CHARITABLE DONATIONS WILL BE USED

The common law has long imposed liability on persons who make fraudulent misrepresentations for the purpose and with the effect of inducing others to act in justifiable reliance on the misrepresentations. See Restatement (Second) of Torts (Restatement) § 525 (1977); *e.g.*, *Stewart* v. *Wyoming Cattle Ranche Co.*, 128 U.S. 383 (1888). Under those longstanding principles, a misrepresentation is fraudulent if the maker knows or believes that it is false or acts with reckless disregard for its truth or falsity. Restatement, *supra*, § 526(a) & cmt. e. Actionable misrepresentations are not limited to affirmative or literal falsehoods. If a representation is capable of two understandings, one true and the other false, the representation is fraudulent if it is made with the intent that it be understood in the false sense or with reckless indifference as to how it will be understood. *Id.* § 527(a) and (c). A representation is also fraudulent if it "stat[es] the truth as far as it goes," but the maker knows it to be materially misleading because it omits additional or qualifying matter. *Id.* § 529.

Illinois fraud law reflects the same principles. A defendant is liable in damages for fraud if he makes a false

representation of a material fact; he knows the representation is false; he makes the representation with the intent to mislead the plaintiff; and the plaintiff justifiably relies upon the representation to his detriment. See *In re Witt*, 583 N.E.2d 526, 531 (Ill. 1991). Fraud includes "anything calculated to deceive, whether it be a single act or combination of circumstances, whether the suppression of truth or the suggestion of what is false, whether it be by direct falsehood or by innuendo, by speech or by silence." *People ex rel. Chicago Bar Ass'n* v. *Gilmore*, 177 N.E. 710, 717 (Ill. 1931). Consistent with Illinois law, petitioner has alleged that respondents committed fraud when they intentionally misled potential donors by misrepresenting the extent to which donated funds would be used to support VietNow's charitable programs, rather than to profit respondents. The Supreme Court of Illinois erred in holding that the First Amendment bars that fraud action.[4]

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[4] This brief focuses on the reasons that petitioner's common law fraud action is not barred by the First Amendment. Petitioner also alleges that respondents' misrepresentations violated various state antifraud statutes. See note 1, *supra*. For essentially the same reasons, liability under those statutes is also consistent with the First Amendment, at least to the extent it is premised on knowing misrepresentations made with intent to mislead. Violations of those statutes, like violations of similar statutes enforced by the FTC, do not in all circumstances require proof that misrepresentations are knowing and intentional. See, *e.g.*, *Removatron Int'l Corp.* v. *FTC*, 884 F.2d 1489, 1495 (1st Cir. 1989) (construing FTC Act); 815 Ill. Comp. Stat. Ann. 505/2 (West 1999) (in construing Illinois Consumer Fraud and Deceptive Business Practices Act, courts should give "consideration" to FTC and federal court interpretations of FTC Act). The complaint in this case, however, alleges misrepresentations that are knowing and intentional.

A. Fraudulent Speech, Including Fraudulent Chariable Solicitation, Is Not Protected By The First Amendment

1. The government's power to protect the public against fraud "has always been recognized in this country and is firmly established." *Donaldson* v. *Read Magazine*, 333 U.S. 178, 190 (1948). That power is well-established even though fraudulent misrepresentations virtually always involve speech.

The government's interest in preventing fraud is no less important and no more constitutionally problematic in the area of charitable solicitation. When a charity or fundraising organization intentionally misleads donors about the uses to which donated funds will be put, it defrauds both the donors and the causes that they are seeking to help. At the same time, when fraud leads potential donors to question the integrity and reliability of charitable solicitations, the ability of honest fundraisers to raise funds is impaired, and the charitable causes that they represent pay the price. See *Developments in the Law—Nonprofit Corporations*, 105 Harv. L. Rev. 1578, 1645, 1647 (1992) (ability of charities to raise funds is vulnerable to fluctuations in donor confidence). The prevention of fraud in the field of charitable solicitation is therefore a longstanding and important governmental interest. See *Watchtower Bible & Tract Soc'y of New York, Inc.* v. *Village of Stratton*, 122 S. Ct. 2080, 2089 (2002). Unnecessary limits on the government's ability to pursue that interest not only leave the public inadequately protected from deception but also may chill charitable giving.

The government's power to prohibit fraud and to prosecute those who commit it is not restricted by the First Amendment. Fraud is one of the "limited classes of speech, the prevention and punishment of which has never been thought to raise any Constitutional problem." *Chaplinsky* v. *New Hampshire*, 315 U.S. 568, 571-572 (1942). The

intentional lie belongs to "that category of utterances which 'are no essential part of any exposition of ideas, and are of such slight social value as a step to truth that any benefit that may be derived from them is clearly outweighed by the social interest in order and morality.'" *Gertz* v. *Robert Welch, Inc.*, 418 U.S. 323, 340 (1974) (quoting *Chaplinsky*, 315 U.S. at 572). Indeed, false representations affirmatively "interfere with the truth-seeking function of the marketplace of ideas." *Hustler Magazine* v. *Falwell*, 485 U.S. 46, 51 (1988).

For those reasons, it has been settled for more than 60 years that those who seek to extract money from the public through fraudulent misrepresentations are not shielded by the First Amendment. See, *e.g.*, *Schneider* v. *State*, 308 U.S. 147, 164 (1939); *Cantwell* v. *Connecticut*, 310 U.S. 296, 306 (1940); *Donaldson*, 333 U.S. at 191-192. This Court has repeatedly rejected the proposition that the First Amendment "includes a right to raise money * * * by deception of the public." *Donaldson*, 333 U.S. at 192. Instead, as the Court stated in *Schneider*, "[f]rauds may be denounced as offenses and punished by law" without thereby abridging the freedom of speech and the press. 308 U.S. at 164.

2. The government's power to prohibit fraud has coexisted with the First Amendment for more than 200 years not merely because fraudulent speech is unprotected but because the essential elements of common law fraud also provide sufficient breathing room for protected expression. Most significant is the scienter requirement. Falsity alone is not enough to subject a fundraiser to liability for fraud. Instead, the government must prove that the fundraiser knew or believed his representation was false or that he acted with reckless disregard for its truth or falsity. See pp. 10-11, *supra*. That requirement eliminates any uncertainty on the part of the fundraiser about whether his conduct is actually protected and substantially reduces the risk that a

court will mistakenly determine that it is unprotected. In other contexts, such as libel, essentially the same standard has been held to provide sufficient breathing room for protected speech. See *New York Times Co.* v. *Sullivan*, 376 U.S. 254, 280 (1964); *Bose Corp.* v. *Consumers Union of the United States, Inc.*, 466 U.S. 485, 502 & n.19 (1984) (noting "kinship" between *New York Times* standard and "motivation that must be proved to support a common-law action for deceit").

Other elements of fraud law besides the scienter requirement provide additional breathing room for protected speech. For example, the plaintiff must prove that the speaker intended the listener to rely on the misrepresentation and that reliance was justified because the misrepresentation was material. Restatement, *supra*, §§ 525, 537, 538. In many States, including Illinois, fraud must be proved by clear and convincing evidence. See *Hofmann* v. *Hofmann*, 446 N.E.2d 499, 506 (Ill. 1983); cf. *Gertz*, 418 U.S. at 342 (requiring clear and convincing evidence of "actual malice" in defamation cases). And some jurisdictions require that fraud be pleaded with particularity. See, *e.g.*, Fed. R. Civ. P. 9(b).

To the extent that the risk of chilling speech remains a concern, that concern can be accommodated by special procedural mechanisms, such as independent appellate review, that leave the substantive state law of fraud undisturbed. Cf. *Bose Corp.*, 466 U.S. at 498-511 (de novo appellate review of findings regarding actual malice). What the First Amendment does not require is that a fundraiser who intentionally misleads potential donors be excused altogether from liability for fraud. Yet that is what the Illinois Supreme Court mistakenly held here.

B. Fraudulent Charitable Solicitation Frequently Involves Misrepresentations About How Contributions Will Be Used

1. In this case, the State of Illinois seeks to do precisely what this Court has repeatedly endorsed as constitutional–to sanction a charitable fundraiser for using intentional misrepresentations to defraud members of the public. Construed "in the light most favorable to" petitioner (Pet. App. 5), the complaint alleges that respondents made at least two fraudulent misrepresentations. First, they falsely represented that "a significant amount of each dollar donated would be paid over to Vietnow for its charitable purposes while in fact [respondents] knew that * * * 15 cents or less of each dollar would be available" for those purposes. Am. Compl. ¶ 34. Second, they falsely represented that "the funds donated would go to further Vietnow's charitable purposes" (*id.* ¶ 29) when the funds actually were going primarily for private profit. See *id.* ¶ 35 ("the amount of funds being paid over to charity was merely incidental to the fundraising effort" which was conducted "for the private pecuniary benefit of" respondents and their agents).

Respondents allegedly made those misrepresentations through a combination of statements, actions, and omissions. They specifically told potential donors that contributions would be used to provide direct assistance to homeless, ill, and injured veterans, including job training, rehabilitation, food, and assistance with rent and other bills. See pp. 3-4 & nn. 2-3, *supra*. Written materials stated that a "substantial portion of the proceeds will be spent on the cost of the public awareness campaign and our program service," which was described as direct assistance. Am. Compl. ¶ 30, Exh. F. In one instance, a donor was told that "90% or more" of contributions "go to the vets." *Id.* Group Exh. H at C000358. Another donor was told her donation would not be used for "labor expenses" because "all members are volunteers." *Id.*

at C000329. At the same time, respondents failed to disclose "that the campaign was being conducted pursuant to private for-profit contracts" and that "a negligible amount, or only 15%, of all funds raised would be given to VietNow and used for its charitable purpose." Am. Compl. ¶ 37.

2. Those misrepresentations are typical of the charitable solicitation frauds that the federal government prosecutes both civilly and criminally. Those prosecutions frequently involve fundraisers who mislead the public by creating false impressions about how contributions solicited in the name of charity will actually be used.

For example, in one instance, fundraisers told prospective donors that they were calling on behalf of Feed America to ask for help "with the national campaign to help Feed America." *United States* v. *Ciccone*, 219 F.3d 1078, 1081 (9th Cir. 2000). Donors were told that "[w]hat Feed America does is feed the homeless of America" and that it was "about time that we took care of our own people." *Ibid.* Of the more than $2.3 million that Feed America received, it gave less than $150,000 to legitimate charities, and the remainder "was deposited in [the owner's] personal bank account." *Ibid.* In another case, the defendant ran two charities and a telemarketing operation from his residence. *United States* v. *Cherna*, 184 F.3d 403, 405-406 (5th Cir. 1999), cert. denied, 529 U.S. 1065 (2002). The telemarketers for one of the charities told prospective donors in Massachusetts that "donations would benefit local veterans' hospitals" and "would be used to purchase medical supplies for hospitalized veterans." *Id.* at 410. In fact, the charity donated only $650 to Massachusetts veterans hospitals, and its nationwide donations totaled only one-tenth of one percent of its total income. *Ibid.*[5]

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[5] See also, *e.g.*, FTC Resp. To Mot. For Judgment On The Pleadings 18, *FTC* v. *Gold*, No. CV-99-2895-CBM (C.D. Cal. filed Nov. 6, 2000) (defendants falsely represented that donations would support charitable

Some fraud cases involve fundraisers who pay charities a flat fee in exchange for using the charities' names to raise money. For example, in *United States* v. *Kinney*, 211 F.3d 13 (2d Cir. 2000), a fundraiser contracted with a charity to solicit contributions in the charity's name by selling advertising space in journals. The fundraising agreement provided for $40,000 to go to the charity and the remainder to be retained by the solicitor. *Id.* at 15. The solicitation scheme raised over $200,000, the charity received only the flat fee, and no journals were produced. *Ibid.*[6]

Telemarketers sometimes form charities for the express purpose of carrying out fraudulent solicitation schemes. See, *e.g.*, *People* v. *Orange County Charitable Servs.*, 87 Cal. Rptr.2d 253, 258 (Ct. App. 1999) (describing how professional fundraiser caused business associates to form charities for the purpose of entering into fundraising contracts with them). Similarly, for-profit fundraisers sometimes use names that sound like charitable organizations and fail to disclose their for-profit status in order to mislead donors about how contributions will be used. See, *e.g.*, *id.* at 258, 260.

3. The ruling of the Supreme Court of Illinois, if affirmed by this Court, would seriously impair the government's ability to prosecute those kinds of fraud. The state court did not base its ruling on any insufficiency of the allegations in the complaint under Illinois law. Rather, the court concluded that First Amendment principles set out in three decisions by this Court—*Schaumberg*, *Munson*, and *Riley*—foreclose petitioner from pursuing the claim. The court reasoned that those cases prohibit reliance on respondents'

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programs when only de minimis amounts—between .01% and 3.5%—were spent on such programs).

[6] See also Order Den. Mot. To Dismiss Counts And Granting Alternative Mot. To Strike Allegations 1, *United States* v. *Gold*, No. SACR 01-150 DOC (C.D. Cal. Feb. 25, 2002).

retention of 85% of the donated funds to establish the falsity of respondents' representation that a significant portion of donated funds would go to VietNow's direct assistance programs; that *Riley*'s invalidation of a state disclosure statute precludes a fraud action premised on the failure to disclose the percentage of donations actually delivered to VietNow; and that *Riley* indicates that fraud actions of this type impose an unjustifiable chill on protected speech. Pet. App. 13-16. Under the court's view, even if respondents knew their representations were false, intended to mislead potential donors, and did in fact mislead them, the First Amendment bars Illinois from sanctioning respondents and entitles them to continue their fraudulent conduct in the future. In so holding, the court misunderstood this Court's precedents and unjustifiably curtailed the government's ability to protect the public from fraud.

C. This Court's Precedents Do Not Preclude Fraud Actions Based On Misrepresentations That A Significant Portion Of Donations Will Be Spent On Particular Charitable Purposes

Contrary to the holding of the Illinois Supreme Court, nothing in this Court's decisions in *Schaumberg*, *Munson*, and *Riley* suggests that the government may not prosecute fraud actions that are based on misrepresentations concerning the percentage of donations that will go to charity or the particular charitable purposes for which donations will be used. The laws invalidated in those cases prohibited charitable organizations or professional fundraisers from engaging in charitable solicitation if they spent high percentages of donated funds on fundraising—whether or not any fraudulent representations were made during the fundraising. The cases therefore do not place any limitation on the kinds of fraudulent misrepresentations that the government may prohibit. Rather, they reaffirm that the government may prosecute fraudulent misrepresentations

by those who solicit funds in the name of charity provided it does so directly.

1. In *Schaumberg*, *Munson*, and *Riley*, this Court made clear that charitable solicitation implicates significant First Amendment interests and that nonfraudulent charitable solicitation is therefore protected by the First Amendment. See *Schaumberg*, 444 U.S. at 632-633; *Munson*, 467 U.S. at 959; *Riley*, 487 U.S. at 789. Consequently, when, as in those cases, the government regulates *nonfraudulent* charitable solicitation, even as a prophylaxis against fraud, the government must employ "narrowly drawn regulations designed to serve [its legitimate] interests without unnecessarily interfering with First Amendment freedoms." *Schaumberg*, 444 U.S. at 637.

In *Schaumberg*, the Court struck down as insufficiently tailored a local ordinance that categorically prohibited the solicitation of contributions by charitable organizations that used less than 75% of their receipts for "charitable purposes." See 444 U.S. at 622. Similarly, in *Munson*, the Court invalidated a state law that prohibited charities from soliciting if they used more than 25% of donations for fundraising expenses, but exempted charities that could demonstrate that the limit would effectively prevent them from raising contributions. 467 U.S. at 950-951 n.2. And, in *Riley*, the Court declared unconstitutional a state law that prohibited professional fundraisers from retaining "unreasonable" fees and used a three-tiered schedule of retention rates to determine the reasonableness of particular fee arrangements. 487 U.S. at 784-785. The three statutes suffered from the same "primary defect": rather than directly prohibiting actual fraud, "fraud [was] presumed by a surrogate and imprecise formula." *Id.* at 794 n.8. See *Schaumberg*, 444 U.S. at 636-637; *Munson*, 467 U.S. at 966-967.[7]

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[7] The Court in *Riley* also struck down a state law that required every professional fundraiser to disclose, at the outset of any solicitation, the

Schaumberg, *Munson*, and *Riley* thus establish that a State may not attack fraudulent charitable solicitation by enacting a broad prophylactic ban on activities that are not themselves fraudulent, at least when the prohibition significantly impairs the ability of charities to engage in protected speech. At the same time, however, all three cases make clear that nothing in the First Amendment prevents a State from directly pursuing actual fraud by those who solicit funds in the name of charity. Indeed, direct prohibitions on fraudulent speech were the narrowly drawn alternative against which the broader prophylactic rules were judged.

In *Schaumberg*, the Court emphasized that "[f]raudulent misrepresentations [by fundraisers] can be prohibited and the penal laws used to punish such conduct directly." 444 U.S. at 637. In *Munson*, the Court similarly stressed that "concerns about fraudulent charities[] can [be] and are accommodated directly" through "penalties for fraudulent conduct." 467 U.S. at 968 n.16. And, in *Riley*, the Court emphasized once more that States need not "sit idly by and allow their citizens to be defrauded." 487 U.S. at 795. Instead, "the State may vigorously enforce its antifraud laws to prohibit professional fundraisers from obtaining money on false pretenses or by making false statements." *Id.* at 800.

As the Court explained in *Schaumberg*, penalizing fraudulent misrepresentations "may help make contribution decisions more informed, while leaving to individual choice the decision whether to contribute to organizations that spend large amounts on salaries and administrative expenses." 444 U.S. at 638. Thus, rather than being constitutionally suspect, direct prohibitions on fraudulent misrepresentation are a "less intrusive," narrowly tailored, and constitutionally

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average percentage of charitable contributions that the fundraiser had turned over to the charities for which it raised money during the previous 12 months. 487 U.S. at 786. The implications of that holding are discussed at pp. 23-26, *infra*.

preferred means of furthering the government's "legitimate interest in preventing fraud." *Id.* at 637.

2. Here, petitioner is doing what the Court expressly approved in *Schaumberg*, *Munson*, and *Riley*. Petitioner is pursuing fraud directly and is holding respondents responsible only because their solicitation was knowingly and intentionally false. Petitioner is not employing a "[b]road prophylactic rule[]" (*Schaumberg*, 444 U.S. at 637) that has "no nexus * * * [to] the likelihood that the solicitation is fraudulent" (*Riley*, 487 U.S. at 793). Instead, petitioner is pursuing fraud in the most direct and "narrowly drawn" way possible (*Schaumberg*, 444 U.S. at 637)–by seeking to attach liability to fraudulent misrepresentations themselves. Petitioner's fraud claim thus falls on the constitutional side of the line drawn by the Court's cases–the line "between regulation aimed at fraud and regulation aimed at something else in the hope that it would sweep fraud in during the process." *Munson*, 467 U.S. at 969-970.

Another significant difference between the fraud claim here and the percentage limitations in *Schaumberg*, *Munson*, and *Riley* is that those laws actually prohibited truthful charitable solicitation, if the government deemed fundraising expenses excessive. Fraud law, in contrast, does not prohibit fundraisers from engaging in charitable solicitation no matter how high their expenses. As long as they do not intentionally mislead donors regarding how their contributions will be used, fundraisers who retain a high percentage of contributions are free to solicit.

Accordingly, this Court's observations in *Schaumberg*, *Munson* and *Riley* that there may be legitimate reasons for a charity's high solicitation costs or a solicitor's high rate of retained receipts do not cast any doubt on this fraud prosecution. Contra Pet. App. 13-15. No matter how high a charity's fundraising costs, or what percentage of donations are used to provide direct services, the law of fraud poses no

obstacle to fundraisers who avoid intentional misrepresentations. For example, if a charity was conducting an advertising or awareness campaign that advanced charitable purposes in conjunction with its fundraising activity, its representation that donated funds were going to "charitable purposes" would not be misleading, much less intentionally so. But here respondents are alleged to have represented not just that donated funds would be used for charitable purposes but that a substantial portion would be spent on direct assistance to veterans when they knew it would not, and to have represented that the fundraising was not for profit when they knew it was primarily for their own pecuniary benefit. Those representations are no less false because some funds may also have been used to promote public awareness or to produce advertising material.

There is no reason to exempt statements concerning fundraising costs or the intended use of donated funds from prohibitions on fraud. Donors place great importance on how their donations will be used, particularly whether they will be used for charitable programs rather than fundraising and administrative costs. See, *e.g.*, Better Business Bureau Wise Giving Alliance, *Donor Expectations Survey* 4-6 (Oct. 17, 2001) *available at* <http://www.give.org/news/Donor%20Expectations%20Survey.pdf>. The Illinois Supreme Court would appear to grant solicitors immunity even if they affirmatively misrepresent that highly material information. Indeed, the court affirmed the complaint's dismissal notwithstanding allegations that a donor "specifically asked" what percentage of her contribution would go to fundraising "and was told 90% or more goes to the vets" (Am. Compl. Group Exh. H at C000358) and that written material stated that "*[a] substantial portion of the proceeds will be spent on* the cost of the public awareness campaign and *our program service*" (*id.* Exh. F (emphasis added)).

D. Nothing in *Riley* Precludes Fraud Claims Based On Implied Misrepresentations About How Charitable Donations Will Be Used

1. Although the allegations just described could be viewed as affirmative misrepresentations, the Supreme Court of Illinois either overlooked them or determined that they did not amount to literal falsehoods. The court stated that the complaint contained "no allegation that defendants made affirmative misstatements to potential donors." Pet. App. 2. In the absence of affirmative misstatements, the court regarded imposing liability for fraud as tantamount to "plac[ing] on solicitors the affirmative duty to disclose to potential donors, at the point of solicitation, the net proceeds to be returned to the charity." *Id.* at 15. The court regarded that result as inconsistent with this Court's invalidation of the compulsory disclosure statute in *Riley*. *Id.* at 16. Contrary to that conclusion, even if the complaint were viewed as alleging no affirmative misrepresentations, its allegations would still be sufficient to bring it within the traditional contours of common law fraud and to place it outside the boundaries of the First Amendment.

The common law of fraud draws no distinction between one who intentionally misleads through explicit misrepresentations and one who does so through implicit misrepresentations or ambiguous representations calculated to produce misunderstanding. See pp. 10-11, *supra*. In each instance, both the speaker's goal and the effect are the same–to "purposely produce[] a false impression upon [the listener's] mind." *Stewart*, 128 U.S. at 390. In each instance, "the deception may often be as base, and the injury to others as great." *Hays* v. *Meyers*, 107 S.W. 287, 288 (Ky. 1908). It is the intent to deceive and the resulting deception that support liability for fraud. And it is the same intent and the same result that deprive fraudulent misrepresentation of

protection under the First Amendment, whether the misrepresentation is express or implied.

Contrary to the Illinois court's belief, *Riley* does not require a different result. In addition to invalidating the percentage limitation discussed above, the Court in *Riley* also struck down a related provision that required every professional fundraiser to disclose, at the outset of any solicitation, the average percentage of charitable contributions that the fundraiser had turned over to the charities for which it raised money during the previous 12 months. 487 U.S. at 786. The Court characterized that provision as a "prophylactic rule of compelled speech, applicable to all professional solicitations," and subjected it to "exacting First Amendment scrutiny." *Id.* at 798. The Court invalidated the law because it was an "imprecise" "burdensome rule," and "more benign and narrowly tailored options" were available to serve the State's goal of preventing donors from being misled. *Id.* at 800. Among the "narrowly tailored options" identified by the Court was the State's ability to "vigorously enforce its antifraud laws" against charitable solicitors who "obtain[] money on false pretenses or by making false statements." *Ibid.*

It is one thing to compel every fundraiser to disclose certain information, but it is quite another to treat the failure to disclose that information, when it is accompanied by other affirmative statements and misrepresentations, as the basis for a fraud claim. The former is an over-inclusive requirement that compels speech by even the most scrupulous fundraiser; the latter is a narrowly tailored prohibition that applies only to fundraisers who intentionally mislead. The Court's invalidation of the over-inclusive disclosure rule in *Riley* thus does not call into question petitioner's ability to prosecute respondents for purposely creating a false impression that a significant percentage of donations would go to specific charitable programs by, among other things, failing

to disclose that, in fact, only about 3% of gross donations would be devoted to those purposes.

In contrast to the disclosure law in *Riley*, Illinois fraud law imposes not a duty to disclose, but only a duty not to intentionally mislead. Common law fraud requires charitable solicitors like respondents to disclose information only when their own words–here, respondents' representations that contributions would be used for particular charitable programs–would otherwise mislead the listener, and where they intend or foresee that the listener will be misled. See Restatement, *supra*, §§ 527(a)-(c), 529, 551(2)(b). There is nothing constitutionally invidious about a rule of liability that compels someone to provide information, if at all, only when his own words would otherwise "purposely produce[] a false impression upon [the listener's] mind" (*Stewart*, 128 U.S. at 390). Freedom of speech may well "compris[e] the decision of both what to say and what *not* to say" (*Riley*, 487 U.S. at 797), but it does not comprise the right to use ambiguities and half-truths in order to deceive.

To the extent that petitioner's complaint alleges that respondents committed fraud by misleading donors into believing that contributions would not go to profit respondents, there can be no question that the complaint is permissible under *Riley*. The misimpression that the fundraising was not a profit-making enterprise could have been cured if respondents had disclosed their professional, for-profit status. And the *Riley* opinion expressly states that a disclosure requirement of that nature is constitutional. See 487 U.S. at 799 n.11.

Riley thus does not limit fraud in the area of charitable solicitation to literal and express falsehoods. Such a limitation would seriously impair the government's ability to protect the donating public from deception. There would be no recourse against a fundraiser who asserted that he was collecting money "to feed the homeless" but intended to use

only one penny out of every hundred dollar donation for that purpose and to use the rest for personal luxury items. Nor could the government take action against a fundraiser who informed donors that he was collecting money for a particular charity when he intended to give the charity a fixed dollar amount from the proceeds regardless of how much he actually collected. The government also would be barred from pursuing fraud actions against fundraisers who incorporate charities for the very purpose of contracting with them to solicit contributions, the lion's share of which will go for the fundraisers' personal profit. The First Amendment does not require that the government countenance such "shabby attempt[s] to get the benefit of a fraud, without incurring the responsibility." *Smith* v. *Chadwick*, 9 App. Cas. 187, 201 (1884) (Lord Blackburn) (appeal taken from Eng. C.A.).

2. *Riley* also does not suggest that a prosecution like the one in this case unjustifiably chills protected speech. Relying on *Riley*, the Supreme Court of Illinois expressed concerned that, if a State could pursue claims of fraud like the one here, protected speech would suffer "a substantial chilling effect" because fundraisers "would have the burden of defending the reasonableness of their fees, on a case-by-case basis, whenever in the Attorney General's judgment the public was being deceived * * * because the fundraiser's fee was too high." Pet. App. 16. Direct prosecutions of fraud do not, however, present the same chilling effects that this Court identified in *Riley*.

This Court's concern in *Riley* that case-by-case litigation about the "reasonableness" of fundraising fees would "chill speech" arose primarily because the statute there placed the burden of proof on the fundraiser. 487 U.S. at 793-794. The Court has frequently concluded that, to avoid chilling protected speech, the government must bear the burden of proving that the speech it seeks to prohibit is unprotected.

See *Freedman* v. *Maryland*, 380 U.S. 51, 58 (1965); *Speiser* v. *Randall*, 357 U.S. 513, 525-526 (1958). But the government *does* bear the burden of proof in a fraud action.

In addition, the statute in *Riley* posed a particular risk of chilling speech because liability did not depend on the truthfulness of the solicitor's representations. The only way to avoid the risk of litigation was to cease soliciting. Here, in contrast, liability for fraud depends entirely on the truth of the solicitor's representations. Accordingly, a solicitor can avoid liability by avoiding misrepresentations and providing enough information to ensure that his representations are not misleading. As a result, the potential for fraud liability should not lead individuals to cease soliciting, but rather should result in more speech rather than less.[8]

That result is entirely consonant with the First Amendment, for it furthers the public interest in receiving "truthful information about a matter of public significance." *Smith* v. *Daily Mail Publ'g Co.*, 443 U.S. 97, 103 (1979). And, if informed members of the public decide, after hearing a fundraiser's solicitation, that they would prefer to direct their charitable donations elsewhere, that too is consistent with First Amendment values. See *Schaumberg*, 444 U.S. at 637-638.

As discussed above, the essential elements of common law fraud themselves provide sufficient breathing room for protected speech, including charitable solicitation, and any further protection that may be necessary can be provided by additional procedural safeguards such as independent appellate review. See pp. 13-14, *supra*. The Illinois Supreme

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[8] Moreover, the statute in *Riley* imposed a distinct chilling effect on charitable solicitation. The law of fraud, by contrast, imposes no more chilling effect on charitable solicitation than on any other form of speech that can be used for legitimate purposes or misused for fraudulent purposes. The law of fraud has never been thought to chill speech impermissibly by creating an incentive to avoid fraudulent statements.

Court mistakenly concluded that those protections are insufficient. Instead, the court restricted the scope of fraud to affirmative misstatements or claims where the falsity of a solicitor's representations is not proved by the amount of donated funds he retains. As the Court has held in the libel context, however, such substantive limits on the concept of falsity are not necessary to protect First Amendment values. Thus, the Court has held that the First Amendment does not preclude a libel action based on an expression of opinion that implies a false statement of fact. *Milkovich* v. *Lorain Journal Co.*, 497 U.S. 1, 18-21 (1990). And the Court has "reject[ed] any special test of falsity for quotations." *Masson* v. *New Yorker Magazine, Inc.*, 501 U.S. 496, 516 (1991). Similarly, no special test for falsity is warranted here.[9]

[9] Rather, falsity is determined by "the effect [that the representations] would produce, under the circumstances, upon the ordinary mind." See W. Page Keeton, *Prosser and Keeton on The Law of Torts* 736 (5th ed. Hornbook Series Law. ed. 1984). One well-accepted method of establishing the effect that representations have on the general public's understanding is a methodologically sound survey. See *Kraft, Inc.*, v. *FTC*, 970 F.2d 311, 318 (7th Cir. 1992), cert. denied, 507 U.S. 909 (1993). Expert opinion testimony, and, to a more limited extent, consumer testimony may also be relevant. See *id.* at 318.

CONCLUSION

The judgment of the Supreme Court of Illinois should be reversed.

Respectfully submitted.

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