New Jersey
Appleseed

To: NJ for Healthcare
From: Renée Steinhagen, NJ Appleseed PILC
(with the assistance of Joel Edman, NJ Inst. for Social Justice)
Date: October 24, 2011
Re: Understanding independent government agencies and nonprofits performing a governmental function

Pursuant to the Patient Protection & Affordable Care Act ("ACA"), the State may establish its health insurance exchange as "a governmental entity or nonprofit entity" to operate the insurance exchange or exchanges. ACA §1311(d)(1). Under New Jersey law, this means that the State may choose to operate its exchange within an executive department, as an independent governmental agency or as a nonprofit corporation established for such purpose. The choice among the three models requires considerations regarding expertise, conflict of interest among regulators and regulated entities, financing of the exchange, accountability with respect to rules governing participation of insurance plans and premium and cost-sharing subsidy determinations, and transparency of decision-making generally.

The following is an analysis of the legal implications of organizing state health exchanges as an independent governmental agency or a nonprofit. Based on the principles articulated by NJ for Health Care Coalition, we do not explore establishing the exchange within a government department and thus operated solely by state employees.[1] Furthermore, with

[1] Which agency? The Department of Banking and Insurance with its expertise in insurance regulation and actuarial matters, or the Department of Human Services with its expertise in the administration of subsidized insurance programs, or the Department of Health and Senior Services with its expertise in the delivery of health

New Jersey Appleseed
Public Interest Law Center of New Jersey
744 Broad Street, Suite 1600
Newark, New Jersey 07102

Phone: 973.735.0523 Fax: 973.735.0524
Email: rsteinhagen@lawsuites.net
Website: www.njappleseed.net

respect to independent governmental agencies, we draw a distinction between boards, commissions, and councils on one hand and public authorities[2] or public corporations on the other. This is the case because under New Jersey law there is no legal distinction as to whether an agency is organized as a board, commission, committee or council. See John Weingart, Another Government Success Story: Citizen Volunteers on New Jersey State Boards and Commissions, Eagleton Institute of Politics, 2 (January 2004));[3] however, state and local authorities (and a public corporations, such as the New Jersey Transit Corporation, "N.J. Transit")) do have the authority to issue tax-free bonds (called notes or credit obligations in the statute governing N.J. Transit, N.J.S.A. 27:25-5(w)), own property, make loans and/or provide services, thus enabling them to finance their own operation. Clayton v. Kervick, 52 N.J. 138 , 150-154 (1968)(where court upheld creation of Educational Facilities Authority because facilities were meant to pay their way from bond revenues unrelated to legislative appropriations and thus did not violate debt limitation clause of Constitution); N.J. Mortgage Finance Agency v. McCrane, 56 N.J. 414, 423 (1970)(same).

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care to ensure quality of service? Moreover, how would one resolve tensions between obligations of the exchange and existing agency obligations, or conflicts of interests between the regulators and the regulated? Such concerns point to the establishment of an entity outside of a current department as the appropriate policy response.

[2] While the state constitution does not define "authorities" as a separate category of legal entities, existing authorities have enough in common to analyze a hypothetical state health insurance exchange authority. What follows is based on the authorizing statutes of the New Jersey Turnpike Authority (N.J.S.A.27:23-1 et seq.), Sports and Exposition Authority (N.J.S.A. 5:10-1 et seq.), Economic Development Authority (N.J.S.A. 34:1B-1 et seq.), and Water Supply Authority (N.J.S.A. 58:1B-1 et seq.), unless otherwise noted.

[3] Compare North Carolina's 1973 Reorganization Act, North Carolina General Statutes §143B-3, providing the following definitions:

> A commission adopts rules in a quasi-legislative manner and makes decisions in a quasi-judicial manner; A board assists cabinet officers or other top level administrators in developing programs and advises them on departmental priorities; A council provides citizen advisory input to cabinet officers and other top level administrators; A committee either advises cabinet officers or other top level administrators or it advises a commission in detailed technical matters.

Finally, although as a matter of practice, New Jersey's Governors have created temporary programs within departments or advisory task forces as independent bodies without specific legislative authorization, the substantial and institutional nature of the state health insurance exchange requires legislative action as a constitutional matter. Cf. Dalton v. Kean, 213 N.J. Super. 572, 575 (App. Div.), cert. denied 107 N.J. 110 (1986)(allocation of executive and administrative offices within a principal department of state government is a legislative function, and the Governor's authority to reorganize government is limited to that delegated by the Legislature, Art. V, §4, ¶1). Similarly, although the Governor may establish the exchange as a nonprofit corporation to which he consigns some governmental functions (as the Legislature did in 1938 with respect to Blue Cross and Blue Shield of New Jersey, now Horizon), the New Jersey Legislature is equally empowered to regulate that entity (even if unilaterally created by the Governor). Accordingly, it is the Legislature that ultimately has the authority to determine the nature of the exchange's governing board, its purposes, and its operating rules and relationship to regulated insurance entities, health insurance consumers and the public generally. Therefore, in all likelihood, the form of governance that the state insurance exchange takes and the principles animating its operation will represent a compromise between the executive and legislative branches. And it is within this tango that we consumers intend to insert our policy choices. This memorandum is an attempt to set forth the New Jersey case law that would guide and ultimately support our choices.

Constitutional Backdrop for Administrative Agencies

The New Jersey Constitution says very little about administrative "agencies" directly; in fact, it does not expressly authorize them. In accordance with Art. V, §4, ¶¶1 and 2, "[a]ll executive and administrative offices, departments, and instrumentalities of the State" must be

allocated to one of the principal departments of the State, and the head of each department is required to be "under the supervision of the Governor." This requirement has given rise to "independent" administrative agencies that are "in, but not of" their respective departments and accordingly free from supervision by their "home" departments (but not the oversight of the Governor). 37 N.J. Prac., Administrative Law And Practice § 1.4 n. 8 (2d ed.). Notwithstanding this lack of department control or supervision, the independence of an authority is tempered by the power of the Governor to appoint several members to the authorities' governing board (with the advice and consent of the Senate) as well as the power of the Governor to veto the minutes of the authority.[4]

In addition, in creating administrative agencies (within principle departments or "in, but not of" such departments), the Legislature, as a constitutional matter, must provide them with sufficient standards to guide their actions. 37 N.J. Prac., Administrative Law And Practice § 1.11 (2d ed.) (citing Worthington v. Fauver, 488 N.J. 183 (N.J. 1982); Mount Laurel Township v. Department of Public Advocate, 83 N.J. 522 (N.J. 1980)). See also N.J. Mortgage Finance Agency v. McCrane, supra. 56 N.J. at 426 (stating that "the Legislature may not vest unbridled or arbitrary power in an administrative agency;" the law must spell out the operations and public purposes of the Agency to pass constitutional muster.). The Legislature may grant agencies the ability to adjudicate individual cases, so long as those decisions are judicially reviewable. 37 N.J. Prac., Administrative Law And Practice § 1.11 (2d ed.) (citing Jackson v. Concord Co., 54 N.J. 113 (N.J. 1969). Furthermore, "no rule or regulation made by any department, officer,

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[4] See discussion of New Jersey Health Care Facilities Financing Authority's governance structure in John V. Jacobi, Health Insurance Exchanges: Governance Issues for New Jersey (Rutgers, September 2011) at p. 8 (hereinafter, "Governance Issues for New Jersey"); see also N.J.S.A. 27:25-4(f) (requiring minutes of the Board of the New Jersey Transit Corporation, an entity established in the Department of Transportation but as a corporation independent of any supervision or control by that department, be sent to the Governor; and that no action taken at such meeting shall have force or effect until approved by Governor or 10-days after delivery to Governor).

agency or authority of the State" may take effect until it is filed with the Secretary of State or in any other manner provided by law." N.J. Const. Art. V, § 4, ¶ 6 (cited in 37 N.J. Prac., Administrative Law and Practice § 1.11 n.2 (2d ed)). This same constitutional provision also creates a legislative veto over all proposed rules and regulations issued by the executive. N.J. Const. Art. V, § 4, ¶ 6.[5]

With these constitutional principles in mind, we may evaluate which form of entity is best to achieve consumer goal's regarding transparency, accountability and effectiveness.

Open Meetings

A state appointed healthcare exchange board would certainly be covered by the Open Public Meetings Act ("OPMA"), N.J.S.A. 10:4-6 et. seq. An entity is subject to OPMA if it is a "public body" as defined by that statute. Times of Trenton Pub. Corp. v. Lafayette Yard Community Development Corp., 183 N.J. 519 (2005). Pursuant to N.J.S.A. 10:4-8a, a "public body" is an entity empowered "to perform a public governmental function affecting the rights, duties, obligations, privileges, benefits, or other legal relations of any person, or collectively authorized to spend public funds." (emphasis added) Clearly, as a creation of the Legislature, housed "in, but not of" a state department, an exchange organized as an independent agency, such as a board, commission, authority or public corporation, would fit either or both of these criteria.

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[5] Neither New Jersey's Constitution or its nonprofit corporation law, N.J.S.A. 15A:1-1 et seq. speak specifically to the establishment of a private entity with "government" purposes. Under Title 15A:2-1, "[a] corporation may be organized . , . for any lawful purpose other than for pecuniary profit including, without being limited to, any one or more of the following purposes: charitable; benevolent; eleemosynary; educational; cemetery; civic; patriotic; political; religious; social; fraternal; literary; cultural; athletic; scientific; agricultural; horticultural; animal husbandry; volunteer fire company; ambulance, first aid or rescue; professional, commercial, industrial or trade association; and labor union and cooperative purposes." Unlike some states, New Jersey's nonprofit law does not create a separate type of nonprofit corporation known as a public benefit corporation.

The case law interpreting OPMA and OPMA itself, which states that "this act shall be liberally construed" (N.J.S.A. 10:4-21), also support the conclusion that a nonprofit exchange board would be subject to OPMA requirements. A nonprofit health insurance exchange would likely be found to serve a public governmental function. In Times of Trenton, a nonprofit community development corporation was found to be a public body because of its close relationship with the City. Most important to the court was that the City had agreed to put its "full faith and credit" behind debts issued by the nonprofit. 183 N.J. at 523, 531-533 (City pledged its full faith and credit to guarantee $31 million of tax-exempt bonds—debt deemed by the IRS to have been "issued `on behalf' of the State or a political subdivision" of the State). Also significant was that the Mayor and City Council appointed the nonprofit board's entire membership and had the authority to approve or reject the board's plans. Id. at 523. In this way, a nonprofit exchange board that is (i) appointed by state officials, (ii) authorized to determine whether an insurer may participate in the exchange and authorized to obtain and use consumers' personal information related to their qualification to participate in the exchange and receive premium and cost-sharing subsidies, and (iii) financially tied in some way to the State will be deemed to perform a governmental function.

If a nonprofit exchange board is at least partially funded by the State, the board would also be considered a "public body" under OPMA. A nonprofit that spends public funds is a public body, even if those funds do not come directly from the State. For example, associational membership assessments exacted against state colleges by the New Jersey State College Governing Boards Association have been ruled public funds. Council of New Jersey State Coll. Locals, AFT/AFL-CIO v. New Jersey State Coll. Governing Boards Ass'n, 226 N.J. Super. 556 (App. Div. 1988). Further, public funds do not have to be "spent" in the more traditional sense

of the word. In Times of Trenton, the New Jersey Supreme Court stated in dicta that the nonprofit had spent public funds simply by issuing debt that was guaranteed by the City. 183 N.J. at 543. It thus seems very likely that a nonprofit exchange that would receive some type of financial support from the State would be covered by OPMA.

Pursuant to the definition of public body under OPMA, this factor does not favor either an independent agency or nonprofit corporatioin.

Public Records

The Open Public Records Act (OPRA) requires that "government records" be accessible to, and available for review by, the public, whether those records are created by an independent agency or a state-created nonprofit. N.J.S.A. 47:1A-1.1; Times of Trenton, 183 N.J. at 534-535. An agency is covered by OPRA if it is a "board, bureau, office, commission or other instrumentality" within the Executive or Legislative branches, or is "an instrumentality or agency created by a political subdivision" or "any independent State authority, commission, instrumentality or agency." N.J.S.A. 47:1A-1.1 (emphasis added). Accordingly, the statute by its explicit terms brings all independent agencies located within an executive department, created by the State or constituting an independent instrumentality of the State, within its ambit.

The New Jersey Supreme Court has also extended this definition to include nonprofits that could not have been created without governmental approval, even if government does not directly create the nonprofit. Times of Trenton, 183 N.J. at 535**.** More recently, the Appellate Division has held that a law clinic affiliated with and operated by faculty of Rutgers Law School at Newark falls within this definition, noting the Legislature's "strong public policy" in favor of disclosure. Sussex Commons Associates, LLC v. Rutgers, 416 N.J. 537, 550 (App. Div. 2010).

A nonprofit healthcare exchange would be created by legislative and/or executive action, and therefore would certainly be covered by OPRA.

Again, this factor is neutral as to whether consumers prefer that the exchange be organized as an independent agency or nonprofit corporation. However, we should all be aware that OPRA permits exceptions to public access that may be created by statute, N.J.S.A. 47:1A-9, or even an executive order or administrative rule. Slaughter v. Gov't Records Council, 413 N.J. Super. 544, 550 (App. Div. 2010)(citations omitted).

Appointments

In practice, appointments to the exchange board should be no different whether the exchange is a nonprofit or a state agency. This is the case, because in either instance the Legislature will decide the method of appointment and the criteria applied to the governing board. However, it should be noted that the New Jersey Constitution requires "boards, commissions and other bodies" of the State to be appointed by the Governor with the advice and consent of the Senate if they are the "head of a principle department." Art. V, §4, ¶ 4. Literally applied, this requirement only pertains to independent agencies that constitute the heads of principle departments; but over the years, the Legislature has typically made gubernatorial appointments to commission or authority boards (that do not serve as head of principle departments) Senate-confirmable by statute. For example, nine of the eleven seats on the Commission on Cancer Research are appointed by the Governor and must be approved by the Senate. N.J.S.A. 52:9U-4. Similarly, four members of the seven member governing board of the New Jersey Health Care Facilities Financing Authority are appointed by the Governor with the advice and consent of the Senate, N.J. S.A. 26:21-4 (the other three members are *ex officio* government officials); as are four members of the seven voting members of the eight member

governing board of N.J. Transit, N.J.S.A. 27:25-4(b). Moreover, the constitutional requirement that the head of each department be under the supervision of the Governor points to the Governor having the capacity to appoint board members to commissions, boards and authorities, even if such instrumentalities do not serve as head of one of the principle departments, Art. V, §4, ¶ 2, and to approve a board's appointment of its principle executive officer. Art. V, §4, ¶ 4.

With respect to nonprofits, there is no constitutional requirement that the board be appointed by the Governor or that such appointments be approved by the Senate. Accordingly, the Legislature has taken varying approaches when creating such boards, At one extreme, the Foundation for Technology Advancement is governed by a 23-member board, with most members appointed by the Governor, without Senate approval, from specifically enumerated organizations or industries. N.J.S.A. 52:27C-97. Legislators have taken a very different tack in creating the Foundation for New Jersey Public Broadcasting (FNJPB), leaving the number, terms, and selection of directors to be determined by the Foundation's articles of incorporation. N.J.S.A. 48:23-14. Another option is represented by the boards of nonprofit health service corporations, which must include four public members appointed by the Governor with advice and consent of the Senate. N.J.S.A. 17:48E-6(a) (statute governing Horizon Blue Cross Blue Shield, the only health service corporation in the State). Given this range, it is clear that the Legislature has relatively free reign in determining how appointments to nonprofit boards are made.

The level of gubernatorial involvement in the governance of an independent state entity or a nonprofit, as a matter of law, is an important consideration when considering which form better suits consumer needs. The former requires the Governor's supervision, the latter does not (although the Legislature may impose such involvement). Focused executive accountability for

operating the exchange is probably positive as a matter of public policy unless we believe that the Governor will exercise his authority in a negative manner.

Administrative Procedures

New Jersey's Administrative Procedure Act (APA) clearly does not cover state-created nonprofits. N.J.S.A. 52:14B-1 et seq. It only regulates state agencies defined as "each of the principal departments in the executive branch of the State Government, and all boards, divisions, commissions, agencies, departments, councils, authorities, offices or officers within any such department" authorized to promulgate rules or adjudicate contested cases. N.J.S.A. 52:14B-2(a). Rutgers University, for example, is not subject to the APA since it is not located within an executive branch department. Lipman v. Rutgers-State Univ. of New Jersey, 329 N.J. Super. 433, 441 (App. Div. 2000). On the other hand, N.J.Transit, located within the Department of Transportation is subject to the APA. N.J.S.A. 27:25-5(e)(requiring that all rules and regulations be promulgated pursuant to the APA).

It is the inability of the Legislature to compel a private, nonprofit corporation to issue rules and regulations pursuant to the APA or to adjudicate contested cases that will be reviewable by the courts that highlights the primary weakness of using the nonprofit form to control a health insurance exchange. New Jersey courts have been critical of efforts to outsource key governmental functions of the kind implicated by the insurance exchange. For example, as noted above, the exchanges will be responsible for determining whether an insurer or a consumer may participate in the exchanges, and whether individuals are entitled to premium and cost-sharing subsidies. These decisions are essential government functions and there is a general "judicial disinclination to permit the State to delegate to private entities fundamental state powers." Governance Issues for New Jersey at 8 (citation committed). See also New Jersey

Dept. of Transportation v. Brzoska, 139 N.J. Super. 510, 513 (App. Div. 1976)(holding that the power to determine who shall have the right to engage in an otherwise unlawful enterprise may not be validly delegated to private person or body that is not subject to public accountability, especially where exercise of such power is uncontrolled by adequate legislative standards); Group Health Insurance of New Jersey v. Howell, 40 N.J. 436, 445 (1963)(invalidating requirement that Medical Society serve as gatekeeper for all applicants desiring to do business as a health services corporation), aff'd on other grounds, 43 N.J. 104(1964). For this reason, employing the nonprofit form to exercise key State responsibilities without the proper public control typically secured through the applicability of the APA presents serious problems. Accordingly, this factor weighs in favor of constituting the exchange as an independent government entity and delegating to that agency sufficient independence to permit the efficient operation of the exchange while maintaining public accountability.

Civil Service

Whether the Civil Service Act ("CSA") would cover employees of a healthcare exchange is for the Legislature to decide; however, employees of a nonprofit are not likely to be considered public employees for purposes of the statute. This is the case since employees are not covered by the CSA unless they are "in the paid service of the State or some political subdivision to which Civil Service is made applicable by law." Atlantic Community Coll. v. Civil Serv. Comm'n, 59 N.J. 102, 106 (1971)(emphasis added). See also Trustees of Free Public Library v. Civil Service Comm'n, 83 N.J.L. 196 (Sup. Ct. 1912), aff'd 86 N.J.L. 307, 309 (E & A 1914) (holding employees of library, formed as nonprofit corporation, were nonetheless in the "paid service" of the municipality and thus subject to civil service laws); De Angelis v. Addonizio, 103 N.J. Super. 238, 253-256 (Law Div. 1968)(holding that because employees of University

hospital are employees of UMDNJ, not the State or the Department of Higher Education—the department in which the college was established as a corporate entity—and are not paid "exclusively from state tax revenues," they are not entitled to civil service status). Accordingly, unless the employees of a nonprofit corporation created by the State are exclusively paid with state tax revenue, they are not eligible for civil service status.

Civil service status is a constitutional and statutory matter. Pursuant to N.J. Const., Art. VII, §1, ¶2, "appointments and promotions in the civil service of the State and of such political subdivisions as may be provided by law shall be made according to merit and fitness to be ascertained, as far as practicable, by examination. . ." The Title of the Civil Service Act, N.J.S.A. 11A:1-1, makes clear that the Act is intended to regulate employment tenure and discharge of certain State employees and certain employees of political subdivisions. Furthermore, the Legislature has the power to define certain employees as "unclassified," so that they are not covered by civil service protections. N.J.S.A. 11A:3-4**;** N.J. A.C. 4A:3-1.3. Accordingly, which State employees and which employees of political subdivisions are covered is the issue most often addressed by the courts. Specifically, the case law concerning public employees often focuses on whether the employees of certain independent government agencies are covered by civil service.

In order to make this determination, a reviewing court examines the exchange statute in order to ascertain the Legislature's intent as to whether its employees are covered. Matter of Sussex County Mun. Utilities Auth., 198 N.J. Super. 214, 218 (App. Div. 1985) ("Only review of the enabling legislation is sufficient to lead to an understanding of that which the Legislature intended for that agency."); Matter of Pemberton Twp. Mun. Utilities Auth., 205 N.J. Super. 31, 36-39 (App. Div. 1985). Legislative intent may be discerned in several ways. The simplest is if

the statute contains an explicit statement that the CSA does or does not apply to certain groups of employees. Sussex County, 198 N.J. Super. at 216. If the Legislature has a specific intent one way or the other, it is advisable that it make that intent explicit. See e.g., N.J.S.A. 27:25-15 (statute explicitly authorizing Board of N.J. Transit to promote and discharge officers and employees without regard to provisions of civil service act). Lacking an explicit statement, New Jersey courts have used two interpretive methods to discern a legislative intent.

The first is to examine the particular personnel powers – hiring, firing, determining compensation and terms of office, etc. given to a governing board by its authorizing statute, for compatibility with the CSA. For example, the New Jersey Supreme Court found that a county college's board of trustees had personnel powers "wholly incompatible with Civil Service," which "shows a legislative intent to preclude application of" the CSA. Atlantic Community Coll. v. Civil Serv. Comm'n, 59 N.J. 102, 111-113 (1971); see also State v. Parking Auth. of City of Trenton, 29 N.J. Super. 335, 339 (App. Div. 1954). In another case, the Appellate Division examined the personnel powers of a Municipal Utilities Authority and found that it was not in conflict with the CSA. Pemberton Township, 205 N.J. Super. at 37-38. If the personnel powers given to the healthcare exchange are incompatible with the CSA, its employees are likely not to be covered. If compatible, there is a greater chance that a legislative intent to cover those employees will be found.

Second, if the statute authorizing the healthcare exchange explicitly exempts certain positions from the CSA, a court is likely to find a legislative intent that the other employees be covered. Sussex County, 198 N.J. Super. at 217. Following the interpretive maxim *inclusio unius est exclusio alterius*, courts presume that the Legislature would not exempt certain positions from the CSA if it did not think that the rest of the positions would be covered. Id.

If the Legislature's intent is not clear from the text, a court may also look to the relationship between the independent agency and the State. The mere fact that a corporate body or public agency exercises public and governmental functions does not in itself dictate that its employees are in the service of the State. De Angelis v. Addonizio, 103 N.J. Super. at 251 (stating that the "crux is whether the function and life of the particular agency is dependent upon the State in its management and control, and whether it depends solely and entirely upon the financial sustenance it receives from the State through its tax revenues"). In Atlantic Community, 59 N.J. at 107-109, the New Jersey Supreme Court articulated two primary reasons why the county colleges were not required to follow county civil service rules for their nonprofessional and non-instructional employees. First, the board of trustees was endowed with significant governing power that was derived from the State Board of Higher Education, and not the county, despite the fact that the County Bd. of Freeholders created the college and made appointments to its board. Id. at 107-108. Second, the primary funding source for the colleges was the State, though it did receive some annual appropriations from the county. Id. at 110-111.

Financial independence from the relevant government subdivision was also the basis for an earlier Appellate Division decision finding that a parking authority was independent of the City that established it. Parking Authority, 29 N.J Super at 338 (authority held not to be a mere agent of the municipality). The Authority retained its own revenue, was not funded via taxation, was autonomous in its decision-making, and its debts were not backed by the City. Id. A healthcare exchange board or council would not be so independent as to avoid CSA coverage on this theory. It would derive its power from legislative authorization and would likely be funded substantially by the State. Its employees could thus be covered by the CSA, notwithstanding the

absence of legislative intent either way. On the other hand, a health exchange authority that issued its own bonds and did not receive revenue from the State could avoid CSA jurisdiction.

Notwithstanding the validity of this functional/financial analysis, it is clear that the most recent cases hold that legislative intent and not "agency theory" is the "real question" in applying the CSA. Pemberton Township, 205 N.J. Super. at 36 (finding agency theory "superficial" bearing little relation to the "real question of whether the Legislature's or Authority's underlying constituency intended civil service to apply" and holding that Legislature intended the CSA to cover utility authority's employees despite its independence from municipality). Reviewing Atlantic Community and Parking Authority, the Appellate Division in Sussex County found that "[o]nly review of the enabling legislation is sufficient to lead to an understanding of that which the Legislature intended for that agency." Sussex County, 198 N.J. Super. at 218. Assuming that the courts continue to follow in that direction, then the exchange statute would be examined only for legislative intent. As seen above, that clearly leaves the choice to the Legislature in crafting its bill establishing an independent state agency, public corporation or a nonprofit corporation.

From a consumer perspective, if we desire employees of the authority to receive civil service protection, we should advocate establishment of an independent agency such as the Board of Public Utilities, located "in, but not of" a principle department, where employees are exclusively paid by the State. Employees of authorities, public corporations and nonprofits are typically not paid exclusively with state taxation revenues and thus the Legislature is less likely to extend civil service protections to them (though in the past, it has extended such protection to some authorities.

Finances

When analyzing the finances of the proposed state health insurance exchange, one needs to understand whether corporate form impacts the type of monies that can come into the exchange and the treatment of that revenue for purposes of taxation.

States agencies are exempt from taxation on income, such as income from investments or loans, and are empowered to issue tax-free bonds. Frances R. Hill & Douglas M. Mancino, *Taxation of Exempt Organizations* ¶ 20.02 (2003). State authorities and public corporations, though typically operational and financially independent from the State, are considered instrumentalities or "arms" of the State performing government functions, and therefore their revenue is tax-exempt. I.R.S. P.L.R. 9642036 (Oct. 18, 1996). See e.g., N.J.S.A. 27:25-4(a)(declaring N.J. Transit to be "constituted as an instrumentality of the State exercising" public and essential government functions).

On the other side of the question, statutes establishing independent authorities typically do not contemplate regular state funding for the authorities, or state backing of authority debts. As noted above, the latter feature is to avoid constitutional debt level limitations that are otherwise imposed on the State. There are exceptions to this rule, however. For example, the Legislature appropriated an initial $200,000 to the N.J. Mortgage Finance Agency upon its creation to defray initial expenses; notwithstanding this payment, the New Jersey Supreme Court found that the statute otherwise properly insulated the State from the Agency's debts for purposes of Art. VIII, §2, ¶3 of the New Jersey Constitution. N.J. Mortgage Finance Agency v. McCrane, 56 N.J. at 420-23. Another exception to the no state funding trait is the Economic Development Authority, which is entitled to receive certain forms of financial support from the State Treasurer and the Legislature. N.J.S.A. 34:1B-4.1 (authorizing contracts with the State

Treasurer to secure bonds and other obligations of the authority); N.J.S.A.34:1B-7(a)(authorizing appropriations to the Economic Development Fund).

Typically, in addition to issuing tax-exempt bonds or debt obligations, authorities and public corporations are also empowered --- in the fairly representative language of the Sports and Exposition Authority statute --- to "accept any gifts or grants or loans" from the federal or state government, "or from any other source." N.J.S.A. 5:10-5. Accordingly, revenue from services (e.g., transportation, utility, sewage, etc.) or interest from loans is not the only source of income to such entities. State agencies are also eligible to receive tax-deductible contributions. Indeed, if created as a state agency the insurance exchange would be able to receive contributions with the most favorable tax-deductible status, allowing deductions of up to 50% of adjusted gross income under section 170(b) of the Internal Revenue Service (IRS) code. The exchange may need to be authorized by the statute to receive those contributions, but there are examples of such authorizations in other New Jersey statutes. See N.J.S.A. 52:27D-177(authorizing the Commissioner of DCA to accept, as an agent of the State, any gift or grant for any purposes of the Act governing his department).

It should be noted that despite the relative financial isolation from the State, authorities are required to submit annual financial reports to the State, probably due to their ability to issue tax-exempt bonds, and the Governor's ultimate supervisory responsibility of such entities.

A nonprofit might also be tax-exempt under a variety of provisions in the tax code – if it exercises delegated "sovereign powers," is an "integral part" of the state government, or performs an "essential governmental function." These issues are extraordinarily complicated and fact-intensive and should be examined by a tax attorney. For an overview, see Hill & Mancino, *supra* ¶ 20.02-20.07 (2003). A nonprofit exchange might also be organized as a 501(c)(3)

charitable organization, like the FNJPB. See *About NJN*, NJN Public Television and Radio, *available at*: http://njn.net/about/executivedirector.html. Authorizing statutes for other state-created nonprofits in New Jersey have accomplished as much by directing that those nonprofits be "organized and operated in such manner as to be eligible under applicable federal law for tax-exempt status and for the receipt of tax-deductible contributions." N.J.S.A. 48:23-13 Foundation for Public Broadcasting**;** N.J.S.A. 52:27C-96(b)(Foundation for Technology Advancement). Under certain circumstances, an independent nonprofit may be organized as a 501(c)(3) *and* as a arm of the State for tax purposes. While 501(c)(3) status "adds little or nothing to the exemption already enjoyed as a government entity," "major contributors and their legal advisers seem to find greater comfort" in 501(c)(3) status. See Hill & Mancino, *supra* ¶ 20.07 (2003).

A nonprofit exchange should be able to accept the same level of tax-deductible contributions as a state agency if it is an "instrumentality" of the State. The IRS considers six factors in determining whether an organization is an instrumentality of the State:

> "(1) whether it is used for a governmental purpose and performs a governmental function;
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> (2) whether performance of its function is on behalf of one or more states or political subdivisions;
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> (3) whether there are any private interests involved, or whether the States or political subdivisions involved have the powers and interests of an owner;
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> (4) whether control and supervision of the organization is vested in public authority or authorities;
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> (5) if express or implied statutory or other authority is necessary for the creation and/or use of such an instrumentality, and whether such authority exists; and

(6) the degree of financial autonomy and the source of its operating expenses."

I.R.S. P.L.R. 9642036 (Oct. 18, 1996).

These factors militate in the direction of finding a nonprofit exchange to be an instrumentality of the State for IRS purposes. Facilitating a federally mandated program is clearly a government "purpose" or "function," which is performed on behalf of the State. The exchange would not exist without express statutory authorization, and if the governing body is appointed by state officials, the State would exercise significant "control and supervision." While a nonprofit exchange would have a certain degree of financial autonomy in that it could solicit private contributions, it would likely derive significant funding from the State. Finally, while the State may not have the full "powers and interests of an owner," neither would its interests be outweighed by any "private interests involved." That third factor reflects the IRS' concern that contributions be used for "exclusively public purposes" and do not "inure to the benefit of any private individual." See I.R.S. P.L.R. 9853016 (Dec. 31, 1998); I.R.S. P.L.R. 9642036 (Oct. 18, 1996). Here, the purpose would be exclusively public and not intended to benefit any private interests, so there should be no issue.

The greatest difference between nonprofits and state agencies may be in the appropriations process. State-created nonprofits might not typically be included in the appropriations process, and indeed some are supported by the State by other means. The Foundation for Technology Advancement, for example, is authorized to "apply for grants in aid from any department or instrumentality of the State of New Jersey." N.J.S.A. 52:27C-103. FNJPB does not receive state funds, but its private contributions supplement state funding to the New Jersey Public Broadcasting Authority (NJPBA). See New Jersey Public Broadcasting Authority: Combining Financial Statements, June 30, 2009, *available at:* http://njn.net/about/.

On the other hand, a health exchange commission or board may be allocated, through the appropriation process, dedicated funds received by the State through taxation of the insurers participating in the exchange. Cf. Financing of some programs of the Board of Public Utilities through the social benefits charge fund. Needless to say, a healthcare exchange would be a rather unique nonprofit or government agency, and it is difficult to anticipate the myriad ways its funding might work to be sustainable.

From the perspective of IRS treatment of tax-exempt contributions, legislative appropriations and the ability to issue tax-exempt bonds, it appears that it is best to organize the exchange as an independent government agency rather than a nonprofit. However, since the exchange will not be providing fee generating service on the scale of N.J.Transit or a sewage treatment authority, nor financing housing, hospital or economic development projects like other state authorities, it is recommended that the exchange be organized as a commission or board. Like the Board of Public Utilities, the exchange will have a mandate more in the nature of a regulator than a service provider, and thus, an authority or public corporation form is less appropriate.

Conclusion

As shown here, with respect to open public meetings and public records, the Legislature will not bind its own hands by choosing to structure the exchange as a nonprofit, an independent agency, or an Authority, because in each instance such laws would apply. With respect to Board appointments, the Legislature has more flexibility if it decides to form the exchange as a nonprofit corporation than it would have if the exchange were an independent government agency. This is because the Constitution requires the Governor to be the supervisor of all instrumentalities of the Executive Branch. The Legislature may provide civil service protection

to employees of independent government agencies (something that it is not likely to do in the case of a nonprofit); and constitutional delegation of legislative powers would best be achieved through the imposition of the APA on a government agency. Pursuant to the terms of the APA, a private nonprofit exchange would not be governed by the Act, and this may pose serious constitutional and public policy problems in regard to unbridled exercise of legislative functions, transparency and public accountability generally. Finally, the finances of the proposed entity also weigh in favor of organizing the exchange as a government agency, and in particular, we recommend the form of a board or commission rather than public authority.