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SPECIAL SUPPLEMENT

State Funded Human Service Agencies

We have written before about government supported nonprofit human service providers.¹ Nonprofits in this market segment differ from “traditional” charities principally in how they are funded. Whereas “traditional” charities are characteristically funded by private donations and/or a combination of donations and program revenue (a college receives donations and tuition), these nonprofits depend heavily, if not entirely, on government funding. The funding is typically provided under contracts in which the state pays the nonprofit money in return for the delivery of services. An example: The Connecticut Department of Developmental Services enters into a contract with a nonprofit to pay for the operation of group homes for the developmentally disabled.

The history of human service providers is interesting and puts this discussion in context. In medieval England (our legal system is based on English law) the mentally disabled, as but one example of a population needing services, were as likely to be ostracized as they were to be treated humanely – with the Church the most likely source of support. A tradition of secular private charity evolved in England and was carried over the Atlantic where it blossomed into our current nonprofit sector.

Here are two early examples of nonprofit human service organizations in Connecticut: *The Connecticut Asylum at Hartford for the Instruction of the Deaf and Dumb Persons* was formed in 1816 due, in large part, to the efforts of a Hartford physician whose daughter lost her hearing at the age of two.² *The Hartford Orphans Asylum* was incorporated in 1833 to provide a home for children “*who are temporarily or permanently deprived of the opportunity of living with their parents...*” Both of these organizations exist to this day – as the *American School for the Deaf* and the *Village for Families and Children*, respectively.

The next evolutionary step occurred in the 1960s when government began to play a role – principally by funding nonprofit providers. The three founding principles behind this were (i) the political conclusion that government has an obligation to assist; (ii) the belief that government (using tax revenue) provides a steadier source of funding than private donations; and (iii) *the conclusion that paying separately incorporated nonprofits to provide services is a more efficient delivery model than government providing services directly.*

Over the past 60 years the government/nonprofit structure has evolved into a colossus that is almost impossible to define. The services include day care, drug and alcohol addiction services, home care for the elderly, autism treatment, support for the mentally or physically disabled, and job training and vocational rehabilitation – to name but a few. If Medicaid is included, the definition expands to nonprofit nursing homes and myriad other services to the poor.

We are writing about these providers again because they have been caught in the snare of the government budget crisis. While no one is immune from the downturn, difficult times often expose underlying weaknesses in a system – and it is no different here. If the second founding principle behind this model envisioned government supplementing private donations to assure steady funding, it has evolved into one in which the government’s control of the funding spigot, one-sided contractual rights and regulatory authority has turned the nonprofits into *de facto* appendages of the government – thereby undermining the third principle that paying nonprofits to provide services is a more efficient delivery model than government providing services directly. An example will put this in focus: in February of this year the Connecticut

¹ See the Winter 2005 edition of this report entitled Connecticut Nonprofit Social Service Agencies, available at www.rrlawpc.com/content/news.

² A \$5,000 legislative appropriation to this organization is apparently the first instance of state aid to special education in the history of the United States.

Department of Developmental Services notified several providers that it was unilaterally changing a program's reimbursement formula – reducing funding for many providers in the middle of a contract year. The providers were mailed the contract amendment and told to return it signed the next day.

Again, no one is immune from hard times, but this example lays bare stark systemic problems: (i) calling the funding arrangements a “contract” is misleading because in a *bona fide* legal contract one party does not have the unilateral power to amend its part of the deal and bears the risk of its inability to perform (*i.e.*, it can be sued),³ (ii) when the state makes a reduction such as this there is no corresponding reduction in the service obligations of the providers so they have to do the same with less; (iii) the care of people with complex conditions is inherently risky, and the state (to avoid liability and criticism) will point its finger at a provider in the event of a loss (such as the death of a client) even if attributable to inadequate funding; and (iv) the financial dependence and unfair allocation of risk and responsibility undermines the governance autonomy of the providers' governing boards which can't afford to “bite the hand that feeds them.”

While researching this topic we found a commentary by Charles J. Chaput, the Catholic Archbishop of the Diocese of Denver, in the November 2009 edition of the journal *First Things*, entitled [A Charitable Endeavor](#). While his criticism of the government's role in this provider model is made in the context of government imposition of policies on Catholic Charities (a massive human services provider) inconsistent with Church teaching, he makes several points that are applicable to all nonprofits in this business. We have paraphrased his comments in the next paragraph – substituting “private nonprofit providers” where appropriate to our point:⁴

Americans have always known that private nonprofit providers are an independent partner in helping the government to meet its charitable goals. They are not an arm of the government. They are not a private contractor on the state payroll. The tax exemptions offered to the private nonprofit providers to help their work are not a gift or a display of kindness. They are nakedly practical. Private nonprofit providers typically do better social-service work than government agencies and at lower cost.

If we step back to look at the historical progression discussed above, we see that this movement was born of private individuals giving of their time and resources to assist people in need. And in principle the concept of government playing the role of a middleman/funder makes sense because raising necessary funds in the form of private charitable contributions is very hard work. However, the reliance on the easier money has come at a steep price – one that is undermining the ability of the sector to do what it does best and what the government does not do well at all.

The Reid and Riege Nonprofit Organization Report is a quarterly publication of Reid and Riege, P.C. It is designed to provide nonprofit clients and others with a summary of state and federal legal developments which may be of interest or helpful to them.

This Special Supplement of the Nonprofit Organization Report was written by John M. (Jack) Horak, Chair of the Nonprofit Organizations Practice Group at Reid and Riege, P.C., which handles tax, corporate, fiduciary, financial, employment, and regulatory issues for nonprofit organizations. While this supplement provides readers with information on recent developments which may affect them, they are urged not to act on this supplement without consultation with their counsel. For information or additional copies, or to be placed on our mailing list, please contact Carrie L. Samperi at (860) 240-1008 or info@rrlawpc.com, or members of Reid and Riege, P.C., One Financial Plaza, Hartford, CT 06103. For other information regarding Reid and Riege, P.C., please visit our website at www.rrlawpc.com.

³ For example, the standard Connecticut contract basically allows the state to cancel or to reduce its payments at any time if funding dries up or if the governor or legislature reallocates funding. A newly adopted version says that the state agency can terminate the contract in whole whenever it determines that it is in its best interest to do so. This would be like having a provision in your mortgage saying that you can stop or reduce payments whenever it is in your best interests do to so, with the bank powerless to object.

⁴ [A Charitable Endeavor](http://www.firstthings.com/issue/2009/01/november) is available at <http://www.firstthings.com/issue/2009/01/november>.