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To:	Clients and Friends
From:	Manatt, Phelps & Phillips, LLP
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Subject:	2009 Deficit Reduction Plan Passes—and 2009-10 Budget Negotiations Begin

Introduction and Overview:

On February 3rd, the New York State Legislature debated and passed a revised version of Governor David Paterson's proposed Deficit Reduction Program (DRP) in order to allow the State to close the current year (2008-09) budget deficit—estimated at $1.6 billion. Through a combination of budgetary actions—including reductions in health care spending, reductions in certain legislatively added items in the current year budget, increased assessments on insurers and a redirection of a portion of the SUNY tuition increase to the benefit of the general fund—the Legislature not only eliminated the current year budget deficit, but reduced the next fiscal year's budget deficit by $800 million. We have summarized the various elements of the bill below.

Even before the ink dried on the DRP, the focus of legislative deliberations turned to the 2009-2010 budget. The Governor had hoped the next year's fiscal plan would be in place as soon as March 1, but the challenge of putting the budget in place in the next two weeks has convinced Governor Paterson to set his sights on an on-time April 1 budget instead. While the Legislature is not in session this week, it will return on February 23rd and begin addressing the even larger fiscal challenge associated with next year's budget.

Two additional factors make closing the 2009-2010 budget gap particularly daunting. First, even though the federal stimulus has now been enacted, the details of exactly how New York State will take advantage of the additional federal aid remain unclear. For example, while as much as $8.6 billion may inure to New York State from the increase in the federal share of Medicaid over the next 27 months, it will up to the Governor and the Legislature to decide what share of those resources might ultimately be devoted to restoring health care cuts or be utilized for other purposes. Even the precise amount of federal support available to New York from other aspects of the federal stimulus legislation remains uncertain.

Secondly, the State's fiscal condition continues to deteriorate, making it difficult to know, from one day to the next, what the projected 2009-2010 budget deficit actually is. Indeed,

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just last week, the State Assembly formally forecasted its estimate of projected State revenues and, somewhat uncharacteristically, the Assembly assessment of the State's economic picture was even more pessimistic than the Executive's. As a result of the Assembly's analysis, it now appears that the operative estimate of the 2009-2010 budget deficit increased by a billion dollars to $14 billion.

The process of enacting the DRP may also presage what might occur when the State Budget is poised for passage in a month and a half. The bill was principally negotiated between the Governor's office and the Democratic leaders of the two houses, with very little, if any, input from the Republican minorities. The Senate passed the bill without a single Republican vote. One might expect that the overall State Budget will also require each of the 32 Senate Democrats to vote affirmatively on budget bills that enact painful reductions in popular programs and unpopular revenue and tax increases.

While budget negotiations are poised to enter a much more serious phase in the weeks ahead, we have summarized below a number of the key provisions of the DRP to bring you up to date on the process undertaken to close the current year's budget gap.

The Deficit Reduction Program:

The DRP closed the $1.6 billion current year budget gap through a combination of targeted budget reductions, increased assessments on the insurance industry, the transfer of funds from public authorities and the State University of New York (SUNY) and Medicaid rate reductions. The actions included the following:

Insurance Assessments: The Governor's Budget proposal released in December proposed a number of increased assessments on insurers as well as increased taxes on insurance premiums and fees upon claims adjusters who process claims for self-insured customers. In the enacted Deficit Reduction Plan, the Legislature and Governor adopted two major changes:

First, the DRP enacted the Governor's proposed increases in the covered lives assessments. There is a "supplemental" or special increase of $110 million for the period October 1, 2008-March 31, 2009 and there is also a "regular" increase of $120 million per year for both calendar year 2009 and calendar year 2010. These are the same increases the Governor proposed in December. Insurers and business groups argued the increased assessments would be passed through to employers and others purchasing health insurance and thus make health insurance costs even more unaffordable. The Governor is quoted in the newspaper as stating that insurers have sufficient reserves and thus insurers need not pass these increases on to customers.

Second, the DRP shifted funding for the Healthy New York and two individual market insurance programs from the HCRA pools to the Insurance Department's assessments on the insurance industry. Funding for the State's subsidies for Healthy New York and the mandated individual market products had been funded from the so-called HCRA tobacco pool (not funded directly by health plans), which is separate from the pools funded by the per claim hospital surcharges and the covered lives assessments paid by health plans. These pools had generated $132 million per year for individual (non-group) Healthy New York customers and up to $131 million for group customers. The direct payment product subsidies have been $40 million per year.

The new legislation deleted the existing funding from HCRA and funds the programs from the Insurance Department's State Operations budget. The appropriation is for $139.4 million for Healthy New York, $39.2 million for the direct pay product subsidies, and $2 million for an ongoing pilot project to assist workers in the entertainment industry. The Healthy New York enrollment has not been large enough to utilize the entire prior HCRA allocations ($263 million in total) since the new appropriation is for only $139 million. The bill reduces the product subsidies by 2%.

The Insurance Department budget and appropriation is not paid from the State's general fund, but is generated from an "assessment" on all insurers based on the amount of premiums written in New York by that insurer (an insurer which writes 1% of all insurance premiums in New York pays 1% of the Insurance Department's budget). This budgetary assessment is separate and apart from the HCRA "covered lives assessment" that only health insurers pay based on the number of persons they cover. As a result, Healthy New York and the two individual insurance market products will now be financed by the annual assessment paid by all insurers, including life insurers, property and casualty insurers, and auto insurers, as well as health plans.

The Governor's December proposal included an increase in the Insurance Department budget assessment to fund a number of public health projects as well as the annual subsidy to small business for the costs of implementing Timothy's Law for expanded mental health coverage. That proposal was estimated to save the State (and thus cost insurers) $179 million. That proposal was not enacted, but the ultimate impact of the increased assessment that was imposed on the insurance industry is almost the same total amount: $180 million.

Trend Factors for Hospitals and Other Providers: The Governor's December Budget proposal contained a number of reductions in Medicaid payment rates, such as elimination of the annual "trend" or inflation factors for both 2008 and 2009, as well as across the board reductions in hospital rates of 2% for 2008 and 2009. Those proposals were separate from the Governor's proposals to "reform" the payment rate system by making changes in the payment methodology.

The DRP enacted only one general reduction in Medicaid trend factors, which applies to hospitals, nursing homes and home health agencies. Medicaid rates include an interim trend factor based on preliminary inflation data from the federal consumer price index. At the end of the year, the rates are made final by updating the trend factor to utilize the final consumer price index. In most cases, the final consumer price index is higher than the interim index, so the final rates set by DOH are usually higher than the interim rates. The DRP states that there shall be no final adjustment to the 2008 trend factor; the interim trend factor already in the 2008 rates will remain as is.

Workforce Recruitment and Retention: The DRP reduces funding for workforce recruitment and retention in public hospitals by 75% (from $12 million to $3 million), and in public nursing homes by almost 80% (from $5.3 million to $1.1 million).

Nursing Home Rebasing: The DRP includes the Governor's proposal to delay the use of the 2002 base year from January 1, 2009 until April 1, 2009. This would become effective immediately, and is estimated to save $22 million.

"***Legislative Adds" reduced:*** The DRP included "across the board" cuts to a category of programs described as "new legislative programs"—i.e., programs and funding added by the Legislature to the Governor's proposed Executive Budget last year. In some cases, these so-called "legislative adds" include a wide range of programs and initiatives that have been funded for many years by the Legislature. The Governor had proposed a 50% reduction (including the 6% cut), but the DRP reduces these funds by approximately 20%, on top of the 6% cut that was already imposed last August. Although there were a few exceptions to the 20% reduction (including civil legal services), a diverse set of programs received significant cuts: in the health care arena alone, the cuts were directed at the Electronic Health Record Transition Fund for community health centers and clinics, family planning services, numerous HIV/AIDS programs, emergency transportation, and rural home care, among others.

Member items: "Member item" funding, which legislators rely upon to supplement various programs and projects, from Little League field improvements to local health clinic services, is also cut in the DRP. The DRP reduces General Fund support for member items by $30 million, from $45 million to $15 million. This reduction follows a cut to member item funding in August 2008 of $40 million, from $85 million to $45 million. According to legislative fiscal staff, these cuts are not expected to impact existing member item commitments, since the Legislature maintains an unused balance in its member item accounts and tactical delays in disbursement of the funds for certain projects provides the Legislature with necessary flexibility. Uncertainty does exist, however, regarding certain Senate member items and, in the event you are waiting on a Senate item, you should check with the member as to its status.

SUNY: The DRP increased the annual SUNY undergraduate tuition for residents from $4,350 to $4,970. SUNY will be able to retain twenty percent of the increase for new investments. Due to the commensurate resulting increase in grant awards from the Tuition Assistance Program, the additional tuition monies will provide the State with $53 million in net revenue in 2008-09 and $97 million in 2009-10.

NYPA Transfer: The New York Power Authority (NYPA) – which operates a number of hydroelectric and nuclear plants in the State – will transfer $306 million to the State General Fund in 2008-09 and $170 million in 2009-10. While critics have charged that this significant transfer of NYPA money will impact the Power for Jobs program that provides reduced-cost electricity to industries and businesses located in Upstate New York, the State Division of Budget states that the program will be unaffected as the identified funds are for long-term purposes.

Environmental Protection Fund: The DRP reduces the 2008-09 appropriation for the Environmental Protection Fund (EPF) – which provides funding for State land acquisition, State and municipal parks, water quality improvement projects, recycling projects, and other environmental programs – by $50 million, from $255 million to $205 million. Further, the State, through the Environmental Facilities Corporation, will issue bonds to pay for $25 million in EPF capital projects. In total, these actions will provide $75 million in savings in 2008-09.

Cultural Programs: The DRP reduces grant funding for museums and other not-for-profit cultural institutions by $9 million – from $48 million to $38 million. Despite this cut, the Governor states that New York's commitment represents "the highest level in the nation."

Other actions: The DRP relies upon various other actions to generate revenue in the current and next fiscal years, including: (i) "sweeping" excess revenues from several public authorities and special revenue accounts (i.e., accounts administered by the State and established for the deposit of certain fees, such as automobile registrations); (ii) funds from the Attorney General's Litigation Settlement Account; (iii) monies from the State share of settlements reached by the Manhattan District Attorney; and (iv) "sweeping" funds and depositing a letter of credit related to the Statewide Wireless Network – the contract for which was recently terminated by the State.

If you have any questions about the DRP or the status of the ongoing budget negotiations, please do not hesitate to contact the Manatt Albany or New York offices.