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New York Caps State Funding for Executive Compensation & Administrative Expenses of Service Providers

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In order to "prevent public funds from being diverted to excessive compensation and unnecessary administrative costs," New York Governor Andrew M. Cuomo executed an executive order on January 18, 2012 ("Executive Order"), capping both executive compensation and administrative costs that New York State ("NYS" or "State") will pay to for-profit and not-for-profit service providers.[1] The Executive Order appears to be part of a larger ongoing trend of increasing scrutiny of, and attempts to limit, the executive compensation practices of health care, social service, and not-for-profit organizations in NYS and across the country.

This client alert discusses: (i) the Executive Order, (ii) key considerations/questions about the Executive Order, and (iii) related recent developments to put the Executive Order in context.

The Executive Order

The new limitations imposed in NYS by the Executive Order have the potential to adversely impact health care providers and payers that receive Medicaid funding and other service providers that directly or indirectly receive State funds.

Within 90 days following the issuance of the Executive Order (mid-April), each covered State agency that provides "financial assistance or State-authorized payments" to providers of services must promulgate regulations to impose a $199,000 annual cap on executive compensation and to require that no less than 75 percent (increased by 5 percent each year until it reaches no less than 85 percent by April 1, 2015) of State funding be used for direct care or services rather than administrative expenses. Further, these State agencies must also take any other action (including amending agreements

[1] For the Executive Order and press release, see: http://www.governor.ny.gov/press/1182011EO.

with providers) "to address the extent and nature" of a provider's administrative costs and executive compensation eligible for reimbursement by the State.

The NYS agencies covered by the Executive Order include, but are not limited to: the Department of Health, the Division of Criminal Justice Services, the Office for People with Development Disabilities, the Office of Mental Health, the Office of Alcoholism and Substance Abuse Services, the Office of Children and Family Services, the Office of Temporary and Disability Assistance, the Office for the Aging, and the Office of Victim Services.

Further, the Executive Order also includes the following:

- **A waiver** – Each agency's regulations must provide for a waiver from these requirements upon a showing of "good cause" and under "appropriate circumstances," subject to certain approvals.

- **Discretion –** The Executive Order gives each agency some, but highly limited, discretion to adjust the compensation cap annually.

- **Ongoing monitoring** – Each agency must "regularly obtain data" from providers to monitor their compliance with these requirements.

- **The consequences of noncompliance** – A provider's failure to comply with the regulations may form the basis for the termination or nonrenewal of the agency's contract with, or support of, the provider.

Key Considerations/Questions

The Executive Order directs the adoption of new regulations but leaves many questions open. The multitude of considerations to be addressed in the regulations includes, by way of example, the following:

- **What accounting methodology will be used to apply the caps on compensation and administrative expenses?**

    - Will the caps be applied on a pure dollar basis or pro rata? (For example, if State funding constitutes 40 percent of an organization's total revenue, will NYS fund only 40 percent of $199,000 (*i.e.*, $79,600) for an executive?)

    - Will the amounts paid by the State vary if an organization receives funding from more than one State agency? What about organizations that have affiliated entities and overlapping management?

    - How will NYS separate out State funding from other revenue sources? What about multistate providers?

- What are the accounting consequences?

- **Which costs are considered capped "administrative expenses?" Which employees are considered "executives?"**

  - What criteria differentiate "administrative expenses" subject to a cap from other costs that are presumably related to patient or client services and will not be subject to the cap? For example, is the human resources department of a medical facility an "administrative cost"? What about quality improvement? Staff training? Facilities maintenance? Food service? Housekeeping? Security? Computers and software? Billing and coding? Medical staff and credentialing? Graduate medical education? Will periodic capital project expenses be subject to the administrative expense cap?

  - Will there be a significant additional burden on the finance departments of affected organizations?

- **Which organizations does the Executive Order really impact?**

  - Hospitals and other provider organizations that have additional significant revenue sources may not feel much impact, given that they have other funds that can be used to cover executive salaries and administrative expenses that exceed the caps. But organizations that rely primarily or exclusively on Medicaid, such as Medicaid-managed care plans, may be heavily affected and may lose their ability to attract and retain talented leadership and otherwise fund important administrative expenses.

  - The Executive Order requires that the regulations apply to providers of services that receive State reimbursements **"directly or indirectly" –** but which organizations are "indirect" recipients of State funds? In theory, the Executive Order could have a very broad reach.

  - What are the consequences for organizations like state-level health insurance exchanges?

- **When would waivers and exceptions be granted?**

  - Will the waivers provide meaningful relief?

  - Also, the Executive Order caps executive compensation payable from State sources "[t]o the extent practicable" – what leeway does that provide?

- Will the waiver authority provide State agencies with the ability to negotiate executive compensation paid by covered entities?

- **The new regulations are due in 90 days, but what will their effective date be? And is 90 days enough time to promulgate the regulations?**

Putting the Executive Order in Context

The Executive Order is only the latest development in a wave of recent efforts by states and the federal government to investigate and regulate the executive compensation and other practices of health care, social service, and not-for-profit organizations. Here are some examples:

- **Recent high-profile abuses** – The media has recently profiled multiple organizations dependent on NYS funds, particularly Medicaid-financed providers of services for the developmentally disabled, for abusive compensation practices.

- **NYS Task Force on Not-for-Profit Entities** – Governor Cuomo created the Task Force in August 2011 to investigate executive compensation at not-for-profit organizations that receive State funding. The Task Force, which was charged with both investigating compensation and recommending new rules, has already collected extensive compensation information from many organizations.

- **The Governor's proposed 2012-13 executive budget** – The budget includes legislation to facilitate the State's involvement in restructuring financially distressed health care delivery systems.

- **Pending NYS legislation** – A bill before the NYS Legislature (A06242) would limit hospital executive compensation to $250,000 at publicly financed hospitals in the State.

- **New Jersey already enacted similar limitations** – In 2010, New Jersey capped compensation paid from certain state contracts with the Departments of Human Services and of Children and Families at $141,000 per year and imposed other rules as well.

For an overview of these and other efforts and suggested best practices, see the recent Epstein Becker Green article entitled "New York Takes Bold Action in Joining the Intensifying Focus on Not-for-Profit Compensation," and view slides from our recent webinar entitled "Spotlight on Executive Compensation in the Healthcare Industry**."**

Final Considerations

Affected organizations should consider the potential consequences of the Executive Order on their organization, and whether they wish to reach out to State agencies to provide input during the next 90 days as regulations are being drafted.

Epstein Becker Green will be working with clients to assess the potential impact of the Executive Order and to facilitate their input to the State agencies.

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*This Client Alert was authored by **Jay E. Gerzog**, **Tamar R. Rosenberg**, and **Wendy C. Goldstein**. For additional information about the issues discussed in this Client Alert, please contact one of the authors or the Epstein Becker Green attorney who regularly handles your legal matters.*

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