

HEALTH CARE LAW ALERT

Executive Order 38 Litigation Update

NYSDOH's regulations under 10 NYCRR Part 1002 (the "use-of-funds rule") promulgated pursuant to Governor Cuomo's Executive Order 38 were upheld by the New York State Appellate Division, Second Department, on December 30, 2015. The Second Department resolved two companion cases, *Concerned Home Care Providers, Inc. v. NYSDOH*¹ and *Agencies for Children's Therapy Servs., Inc. v. NYSDOH*², in which the lower courts had divided over the issue of whether NYSDOH had the authority to promulgate these regulations.

As background, the use-of-funds rule limits how "Covered Providers" (a two-part definition explained below) may use State Funds and State Authorized Payments to compensate executives and also prescribes the use of such funds for administrative overhead of the entity. Covered Providers include entities that have received, on average in the prior 2 years, greater than \$500,000 in State Funds or State Authorized Payments. For purposes of this calculation, State Funds include Medicaid monies as well as other grants and contracts from NYSDOH, but do not include Medicare monies. A Covered Provider must also derive at least 30% of its total annual in-state revenues from State Funds and State Authorized Payments in the previous 2 years.

Once determined to be a Covered Provider, the use-of-funds rule prohibits Covered Providers from using State Funds or State Authorized Payments for executive compensation given directly or indirectly to a Covered Executive in an amount greater than \$199,000 per annum, unless the entity meets a safe harbor or applies for a waiver. Under the safe harbor, executive compensation may not exceed the 75th percentile of compensation paid to comparable executives, and the entity's board (including at least 2 independent directors) must review and approve the compensation based on a review of comparability data.

With regard to administrative expenses, for 2015, no less than 85% of a Covered Provider's covered operating expenses paid for with State Funds or State Authorized Payments must be

¹ 134 A.D.3d 1065 (2d Dep't 2015)

² 22 N.Y.S.3d 524, 2015 N.Y.Slip Op. 09647 (Dec. 30, 2015)

used toward program services, meaning that only 15% may be used for administrative overhead.

In *Agencies for Children's Therapy Servs.*, the Second Department explained that the NYSDOH had broad authority to promulgate the use-of-funds rule, and there was no violation of the separation of powers doctrine. While some entities held out hope that the Court of Appeals would intervene on this issue, the Court declined to hear an initial appeal on February 23, 2016.³ In addition, while a third challenge to the use-of-funds rule was brought in Supreme Court, Albany County, that Court generally upheld NYSDOH's authority to promulgate the regulations, although it found that NYSDOH did not have authority to promulgate the safe harbor.⁴ Accordingly, even if appealed, the Albany County Supreme Court decision is generally in sync with the Second Department's decision.

As such, Covered Providers should be prepared to continue to comply with the use-of-funds rule, keeping in mind that the percentage of state monies that must go to program services increased in fiscal year 2015 to 85% from 80% in fiscal year 2014. Reporting for fiscal year 2015 is due within 180 calendar days following the close of the entity's fiscal year.

Please do not hesitate to contact one of our Firm's health law attorneys identified below if you would like more information on this issue.

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This communication is for informational purposes and is not intended as legal advice.

³ 2016 N.Y. Slip. Op. 64886, 2016 WL 698907 (Feb. 23, 2016).

⁴ *LeadingAge N.Y, Inc. v. Shah*, Index No. 5333/2013 (Sup. Ct. Albany Co. Nov. 13, 2015).