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New York Court of Appeals Invalidates Department of Health Executive Compensation Limitations

On October 18, 2018, the New York Court of Appeals affirmed the unconstitutionality of certain aspects of Department of Health (DOH) regulations which limited executive compensation to \$199,000, as directed by Governor Cuomo’s Executive Order 38. With this decision, some affected organizations may pay executives more than \$199,000 per year without needing to meet certain requirements or obtain a waiver from DOH.

Consistent with the directives from Executive Order 38, in 2013, DOH promulgated regulations which limited the amount of state funds certain providers (including hospitals, nursing homes, home care agencies, hospices, and certain IPAs or management companies related to any of the foregoing) could spend on administrative expenses.

Subsequent constitutional challenges to these regulations have been percolating since 2013, and the Court of Appeals brings finality to three aspects of the regulations.

1. **15% Hard Cap on Administrative Expenses.** The DOH regulations prohibit a covered provider from using more than 15% (decreased in 2015 from 25%) of state funds or state-authorized payments to pay for administrative expenses.
2. **\$199,000 Hard Cap on Executive Compensation.** The DOH regulations also prohibit covered providers from using more than \$199,000 per year of state funds or state-authorized payments to compensate certain executives (including directors, officers, managing partners, or key employees).
3. **\$199,000 Soft Cap on Executive Compensation.** The regulations also imposed penalties on covered providers who paid executives more than \$199,000 per year (including all sources of funding, whether state or non-state), unless:
 - the compensation paid to the executive was below the 75th percentile of comparable compensation;
 - the compensation was reviewed and approved by the provider’s governing body (including at least 2 independent voting members), and such review included an assessment of comparability data; or
 - the provider obtained a waiver from DOH

The Court of Appeals held that both hard cap regulations were constitutional because they are “directly tied to a specific goal dictated [to DOH] by the Legislature – to efficiently direct state funds toward quality medical care for the public.”

However, the Court of Appeals further held that the soft cap regulations on executive compensation were unconstitutional because the regulation of private funds exceeded the bounds of DOH’s authority. The Court

reasoned that “[b]y attempting to control how an entity uses its private funding, DOH has ventured beyond legislative directives relating to the efficient use of state funds and into the realm of broader policy concerns.”

It is important to note that the Court of Appeals’ decision invalidated only the DOH regulation. The regulations of the twelve other state agencies with Executive Order 38 regulations (Department of State, Homes and Community Renewal, Office of Alcoholism and Substance Abuse Services, Office of Children and Family Services, Office of Mental Health, Office for People with Developmental Disabilities, Department of Agriculture and Markets, Division of Criminal Justice Services, Department of Corrections and Community Supervision, Office for the Aging, Office of Temporary and Disability Assistance, and Office of Victim Services) have substantially similar, if not identical, soft caps on executive compensation. The Court of Appeals decision does not render the soft caps on executive compensation found in those regulations unconstitutional. However, it provides significant precedent and authority to invalidate these regulations as well.

Across all state agencies’ regulations, the definition of “state funds” and “state-authorized payments” includes funds appropriated in the annual state budget and any other funds disbursed by any and all state agencies. A list of government programs whose funds are considered “state funds” or “state-authorized payments” can be found here. As a result, affected organizations which receive state funds or state-authorized payments solely from DOH are no longer subject to the soft cap restrictions on executive compensation. Such organizations can use non-state sources to compensate executives in excess of \$199,000 without needing to meet any other procedural criteria or obtain a waiver from DOH. By contrast, organizations which receive state funds from multiple state agencies will still be subject to the soft cap limitations imposed by the other state agencies’ Executive Order 38 regulations. This means that, until these other agencies’ analogous soft cap regulations are deleted by each agency or held unconstitutional by a court, such organizations will still need to comply with the regulatory requirements of the soft cap if they wish to pay an executive over \$199,000, even if non-state funds are used.