

NEW YORK'S HIGHEST COURT STRIKES DOWN THE EXECUTIVE ORDER 38 "SOFT CAP" ON EXECUTIVE COMPENSATION

Hodgson Russ Employee Benefits Newsletter
October 31, 2018

Practices & Industries

Employee Benefits

On October 18, 2018, the New York State Court of Appeals issued a decision striking down Department of Health ("DOH") regulations under Executive Order 38 that limited compensation paid to executives of Medicaid-funded entities when paid from non-state sources. The cap on executive compensation derived from state funds and state-authorized payments remains in place.

Executive Order 38 ("EO 38") and its accompanying regulations limit executive compensation and administrative expenses for covered providers who receive state funds or state authorized payments that exceed \$500,000, and account for 30% or more of the entity's annual revenues.

Respecting executive compensation, the EO 38 regulations established a "hard cap" prohibiting covered providers from using state funds to provide annual compensation greater than \$199,000 to a covered executive. The regulations also imposed a "soft cap" prohibiting a covered executive from receiving more than \$199,000 annually — regardless of the source of the funds — unless certain exceptions apply. "Executive compensation" is broadly defined to include any form of compensation reportable on Form W-2 or 1099, including salary, bonuses, company vehicles, housing, entertainment, travel, etc. The definition also includes nontaxable retirement and welfare benefits to the extent they are not "substantially equal" to employee benefits provided to other employees.

Two groups of petitioners, whose members include Medicaid-funded nursing homes, home care entities and health care plans, challenged the EO 38 regulations on the basis that DOH exceeded its authority under the separation of powers doctrine, and acted in an arbitrary and capricious manner. In consolidated proceedings, the state trial court invalidated the "soft cap," finding that the DOH had "engaged in legislative activity" beyond its regulatory powers, but upheld the "hard cap" as an appropriate regulation within DOH's authority. The Appellate Division concurred.

The New York Court of Appeals analyzed the EO 38 regulations under the four factor test in *Boreali v. Axelrod* to determine whether DOH had overstepped the "the difficult-to-define line between administrative rule-making and legislative policy-making." The Court concluded that DOH properly exercised its powers to

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ensure the appropriate use of state health care funds when it imposed the "hard cap" on executive compensation from public funding sources. In contrast, the Court struck down the "soft cap" as an inappropriate "value judgment" by DOH that executive compensation from all sources, including private funds, should be limited as a matter of public policy.

The decision leaves covered providers with an unclear path forward to pay executives compensation in excess of \$199,000 solely with privately-sourced funds. Waivers on the executive compensation limit remain available under the existing regulations. However, it may be possible for covered providers to use strategies such as the segregation of accounts, or other methods to demonstrate executive compensation is privately-sourced, and compliant with the "hard cap" limit on compensation paid from state-sourced funds. Entities without privately-sourced funding must continue to comply with the executive compensation cap, and all covered providers must satisfy annual reporting and disclosure obligations. *In the Matter of LeadingAge New York, Inc., et al. v. Shah*, 2018 N.Y. Slip Op. 06965, 2018 WL 5046104 (October 18, 2018).