

## New York Court Upholds Executive Pay Caps as State Updates EO 38 Guidance

Last year, the New York Department of Health and 12 other state agencies issued regulations to implement Governor Andrew Cuomo's Executive Order 38 limiting the amount state service providers may pay executives and allocate for administrative expenses. Since then, for-profit and not-for-profit organizations have filed lawsuits challenging the regulations' validity. On July 29, a Suffolk County court upheld EO 38 and the same DOH regulations that a Nassau County court invalidated months earlier. In view of the state's recent announcement that its EO 38 website has been updated and it is generally enforcing the regulations, organizations subject to them will want to ensure compliance while they monitor future developments.

### Background

On January 18, 2012, New York Governor Andrew Cuomo issued Executive Order No. 38 (EO 38) to limit state service providers' use of state funds for executive compensation and administrative expenses. Following prolonged rulemaking, the New York Department of Health (DOH) and 12 other state agencies issued implementing regulations that affected most covered service providers beginning with their 2014 fiscal year. (See our [February 13, 2014 For Your Information.](#)) Both for-profit and not-for-profit organizations have filed legal challenges.

In April, New York Supreme Court, Nassau County Justice Thomas Feinman ruled in *Agencies for Children's Therapy Services, Inc. v. New York State Department of Health* (ACTS decision) that both EO 38 and the DOH regulations implementing its restrictions on service providers were invalid and unenforceable. (See our [April 24, 2014 For Your Information.](#)) A prior ruling by a state Supreme Court judge for Suffolk County took a different view, denying a motion to prevent implementation of the DOH regulations while the court considered their validity.

### Court Upholds Executive Pay Cap

On July 29, Suffolk County Supreme Court Justice Emily Pines ruled in *Concerned Home Care Providers, Inc. v. New York State Department of Health* that the DOH has authority "to regulate the financial assistance provided by the State in connection with public health care activities." Upholding the DOH regulations, the court emphasized that the regulations do not cap the executive compensation or administrative expenses of entities that receive state

funds or state-authorized payments, but only limit the amount of money coming from state sources that can be used for those purposes.

**Comment.** Section 1002.3(b) of the regulations suggests that providers must satisfy the compensation limits or obtain a waiver where executive compensation exceeds \$199,000 per annum (including not only state funds and state-authorized payments but also any other sources of funding) unless the compensation satisfies other requirements including the 75% rule discussed below.

Last week, an Albany Supreme Court justice delivered a setback to the state in a third case questioning the legality of EO 38. In *LeadingAge New York et al. v. Shah*, Judge George B. Ceresia Jr. denied the state's motion to dismiss a challenge to EO 38 by several statewide associations of health care providers, allowing the case to continue.

## EO 38 Website Updates Guidance

On July 1, the state announced that it had updated the EO38 [website](#), and is enforcing agency regulations with one notable exception.

### Limitation on Enforcement

According to a notice posted on the state website, covered providers "conducting business" in Nassau County are not required to file EO 38 disclosures as a result of the ACTS decision. For these purposes, conducting business means "having a place of business within Nassau County, providing program services or administrative services involving the use or receipt of State funds or State-authorized payments within Nassau County, or otherwise conducting business within Nassau County in relation to which executive compensation is paid." The website notes that the ACTS decision is under appeal, and suggests that those affected by the decision should periodically check the EO 38 website for updates.

**Comment.** Whether the notice suspends all EO 38 compliance obligations (including the compensation and expense limits) for Nassau County providers or only the disclosure requirement is unclear. Providers should carefully evaluate their compliance strategies as they continue to monitor the website for further guidance.

While covered providers that conduct business solely in Nassau County will not be required to file EO 38 disclosures, covered providers that are not conducting business in Nassau County remain subject to the requirement. However, it is less clear how the state will treat covered providers that conduct business in both Nassau County and other counties within the state.

### Updated Guidance

Updated [guidance](#) on EO 38 and related regulations as of July 2014 is now available on the EO 30 website, along with an expanded set of frequently asked questions ([FAQs](#)). Among other things, the website now includes an interactive worksheet to assist individuals and entities in determining whether they are covered providers under EO 38 along with step-by-step instructions and a tutorial.

**FAQs.** Importantly, the new FAQs provide detailed guidance on how to calculate executive compensation, and clarifies that executive compensation may include funding from all sources. A number of the FAQs address the treatment of distributions and dividends for purposes of the executive cap, and confirm that only distributions made

for services rendered — compensatory payments — during the current reporting period are included in the calculation of executive compensation under EO 38 regulations.

In determining whether a distribution/dividend is made from the current reporting period's earnings if the provider has both current and accumulated earnings, distributions/dividends are considered to come from current earnings first. Distributions/dividends received by an executive to pay a tax liability are generally counted as executive compensation if they are for services rendered during the reporting period.

Because the regulations take a broad view, executive compensation encompasses all distributions and dividends paid to a covered executive for services rendered, including distributions and dividends related to shares/equity provided for such services. However, equity the executive receives as the result of an open-market or arms-length purchase/investment would not be included in the calculation of executive compensation, nor would dividends or distributions from equity resulting from a generally available employee benefit (such as an employee stock ownership plan or ESOP).

Notably, amounts reported in partnerships (including most LLCs) or in S corporations on the federal Schedule K-1 for services rendered during the reporting period would be included in the definition of executive compensation under EO 38. Benefits that accrue but are subject to forfeiture (such as deferred compensation subject to a vesting schedule based on tenure) would be included as executive compensation, but only the amounts contributed or accruing within the reporting period.

**Acceptable Compensation Surveys.** The regulations provide that a covered executive's total compensation may exceed the \$199,000 annual limitation if it is at or below the 75th percentile of compensation "provided to comparable executives in other providers of the same size and within the same program service sector and the same or comparable geographic area as established by a compensation survey identified, provided, or recognized by the [DOH (or other lead agency)] and the Director of the Division of the Budget." The website includes a [memorandum](#) summarizing surveys that covered providers may use to assess compliance with the 75% rule.

For these purposes, the agencies and the Division of the Budget will recognize any compensation survey that meets all of the following criteria:

- Is consistent with IRS requirements (including actions needed to avoid intermediate sanctions)
- Is consistent with the guidelines in previously released EO 38 Preliminary Guidance
- Uses any of the following –
  - Recognized and publicly available databases that are updated regularly (such as Guidestar or the "Economic Research Institute's Non-Profit Survey"),
  - Provider organization surveys that are comprehensive, regularly updated, and provide sufficient program/location information (such as "Non-Profit Coordinating Committee of New York Salary Survey Results"), or
  - Surveys conducted on behalf of the covered provider by entities that regularly provide salary surveys (including CPA and consulting firms)

## In Closing

Given the conflicting rulings on the validity of EO 38, it is likely that New York's highest court — the Court of Appeals — will ultimately have to decide whether the regulatory limits on executive compensation and administrative expenses can stand. Although the state has indicated it will not require Nassau County providers to file EO 38 disclosures at this time, entities providing program services on a statewide or on a regional basis may still have to file disclosure forms for business conducted in other counties. Pending further clarification, covered providers should closely monitor developments posted on the state's website for notices clarifying their compliance obligations.

### Authors

Nancy Vary, JD  
Alan A. Nadel, CPA

### Produced by the Knowledge Resource Center of Buck Consultants at Xerox

The Knowledge Resource Center is responsible for national multi-practice compliance consulting, analysis and publications, government relations, research, surveys, training, and knowledge management. For more information, please contact your account executive or email [fyi@xerox.com](mailto:fyi@xerox.com).

You are welcome to distribute *FYI*® publications in their entirety. To manage your subscriptions, or to sign up to receive our mailings, visit our [Subscription Center](#).

This publication is for information only and does not constitute legal advice; consult with legal, tax and other advisors before applying this information to your specific situation.