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# BY EMAIL AND HAND DELIVERY

Katherine Ceroalo
Bureau of House Counsel
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Department of Health
Empire State Plaza Tower Building
Albany, NY 12237

Re: Limits on Executive Compensation and Administrative

Expense in Agency Procurements I.D. No. HLT-22-12-00012-RP

Dear Ms. Ceroalo:

On behalf of the Health Law Section of the New York State Bar Association ("the Section"), these comments are being submitted in response to the revised regulations issued by the Department of Health ("the Department") to implement the provisions of Executive Order No. 38. The Health Law Section includes over 1250 health law practitioners from all across New York State, who devote all or a substantial portion of their practices to the representation of health care entities, many of which will be potentially subject to and, we believe, adversely affected by these regulations, which seek to limit executive compensation and to reduce administrative expenses within entities that contract with the State of New York.

Introduction and Overview of Legal and Policy Concerns:

We commend the Department and the Administration for many of the revisions that were made to the regulations, which were responsive to suggestions we and others made during the initial comment period and which have clarified the intent of the regulations and may facilitate compliance with the requirements. Among other revisions, the regulations clarified that certain program-related expenditures should not be regarded as "administrative," exempted certain "executives" who perform principally programmatic roles from the compensation limitations, eased the waiver requirements and clarified a number of the terms

and procedures that would govern the implementation of the Executive Order and these revised regulations.

Nevertheless, the across the board, state agency-supervised, micro-management of executive compensation and administrative expense, as embodied in these regulations, is destined to be a cumbersome, costly, and ineffective approach to issues that are susceptible to a far more targeted enforcement remedy. Before launching an unwarranted intrusion into the operations of the thousands of entities that contract with the State, we would urge the Department and the Administration to reconsider whether a more focused enforcement effort could be directed toward that distinct minority of organizations that provoked these regulations in the first place.

We remain convinced, as well, that the Department and its sister agencies lack the legal authority to launch this unprecedented regulatory foray into the compensation practices of entities that contract with the State. We noted previously the absence of independent statutory or constitutional authority for the Executive Order or the regulations—and nothing in the response to the many comments on this issue or in the revised regulations diminishes that concern.

The Executive Order was issued within twenty-four hours after Article VII budgetary legislation was advanced by the Governor that included a proposal to cap executive compensation and administrative expense through provisions that were virtually word for word identical to the terms of the Executive Order. The Article VII legislative version of the executive compensation/administrative expense proposal was not enacted by the Legislature—and one house of the Legislature included in its one-house budget a proposal that expressly superseded the Executive Order. The Department's comment, in response to these expressed concerns, that the Legislature "did not reject the proposal made in Executive Order #38" is disingenuous. See Boreali v. Axelrod, 71 N.Y.2d 1, 13 (1987) ("it is appropriate for us to consider the significance of legislative inaction as evidence that the Legislature has so far been unable to reach agreement on the goals and methods that should govern in resolving a society-wide . . . problem.")

Even without this unique legislative history, the use of an Executive Order as the basis for a complex regulatory scheme, like the one envisioned by the revised regulations, has been unfavorably viewed by New York courts, as in *Rapp v. Carey*, 44 N.Y.2d 157 (1978), where the Court of Appeals found an Executive Order imposing disclosure requirements on state employees unconstitutional ("Neither in the Constitution nor in the statutes is there express or implied authority for the Governor to exact of State employees compliance with the requirements of Executive Order No. 10.1. Nor does the Governor's order merely implement existing legislation relating to conflicts of interest. The order reaches beyond that, and assumes the power of the Legislature to set State policy in an area of concededly increasing public concern."). *See also Subcontractors Trade Ass'n v. Koch*, 62 N.Y.2d 422, 428 (1985) ("the general power to enter into contracts which is bestowed upon the executive branch of government ordinarily cannot serve as a basis for creating a remedial plan for which the executive never received a grant of legislative power").

The revised regulation's limited "grandfathering" of executive compensation contracts may be viewed as a half-hearted acknowledgement of the potential constitutional issues raised by regulations that would appear to impair contracts entered into by independent entities with their executives. Whatever may be the laudable purpose of these regulations is undermined by advancing a proposal that exceeds the statutory authority of the Department and its sister state agencies and that may exceed the constitutional authority of state government to regulate contractual commitments of legally independent and autonomous private entities, particularly when these commitments involve the expenditure of non-state funds.

In addition, as we reiterate below, we would strongly urge that the Department consider a further delay in the implementation of these regulations. Given the continuing uncertainty as to how covered entities will be able to assure compliance with the proposed regulations—and, in particular, the need for further guidance by state agencies on reporting requirements and forms, the State-sanctioned compensation surveys on which covered providers must rely and the details of the waiver process—we would strongly urge consideration of delaying the implementation of the regulations at least until January 1, 2014 to provide ample time for the State agencies to provide the guidance that will be required to implement the proposed new rules and to give the thousands of affected entities sufficient time to achieve compliance.

Comments on the Revised Regulations: We understand and appreciate why the Executive Order was issued and why these regulations were proposed. Although a number of positive changes were made to the regulations, we continue to believe that the approach embodied in these regulations will hinder the ability of state contractors to recruit and retain highly qualified leadership, will impose substantial reporting and compliance costs on covered providers and will require an investment in state regulatory and enforcement activity that is neither merited by the problem it seeks to solve nor affordable given the fiscal and staffing limitations facing the Department and the State of New York.

Impact on executive recruitment and retention: We commend the inclusion in the revised regulation of a limited "grandfathering" of executive compensation contractual agreements that were in place prior to the 2012-13 fiscal year, but we believe that it is short-sighted and legally unsound to make that recognition of the legal commitment to these executives effectively expire in April, 2014 and to limit the recognition of these contractual commitments to those entered into before April, 2012. (1002.3(h))<sup>1</sup>

We also appreciate the revised regulations' clarification of the definition of "compensation" to exclude most, if not all, conventional benefits (1002.1(f)) and we support the adoption of the Form 990 approach that limits the executive compensation requirements to "those ten key employees whose executive compensation is the greatest during the reporting period."(1002.1(c)). In addition, we applaud the exclusion of certain "clinical and program personnel" from the definition of "covered executive," although we have some concerns as to how this exclusion may be applied to the broad array of entities subject to the regulation. The

<sup>&</sup>lt;sup>1</sup> Citations in parentheses are to the applicable sections of the revised Department of Health regulations to which the comments refer.

descriptions provided of these program-focused executives are explicitly hospital-related and expressly include "chairs of departments, heads of service, chief medical officers, directors of nursing"—titles that are typically used by hospitals and that may not as often be found within other covered organizations. We would assume, however, that the principle would be evenly applied and that any "personnel fulfilling administrative functions that are nevertheless directly attributable to and comprise program services" (1002.1(c)) would also be exempt, regardless of the actual titles employed.

We remain concerned over the potential implications of the executive compensation cap on those executives that would remain subject to it. Section members represent clients that include complex healthcare organizations that have daunting responsibilities in an era of rapid state and federal health policy ferment, particularly as the State implements federal health reform and the recommendations of the Medicaid Redesign Team. The success of these organizations require experienced and talented executive teams and covered providers must be able to compete for that talent and pay what the market dictates. Subjecting these entities to an arbitrary compensation cap, derived from federal civil service schedules, as the benchmark for executive compensation ignores the unique realities of the healthcare marketplace. Given the responsibilities that have been placed on these executives, one would think the Department would be just as concerned about the quality of their leadership as are the governing boards of these health care organizations.

We also remain concerned over the disproportionate impact of these regulations on safety net providers. The impact of the regulations on contracting entities is directly proportional to the degree to which the "covered provider" devotes its mission and resources to public purposes. The revised regulations continue to exempt entities whose state funding or state authorized payments total less than thirty percent. (1002.1(d)(2)). In addition, while some opportunity exists to use non-state money to augment compensation above the \$199,000 cap, covered entities that rely almost entirely on state funding or state-authorized payments are effectively subject to a hard compensation cap at that amount (1002.3(a)), subject only to whether a waiver may be granted. As a result, healthcare organizations that do not engage primarily in the provision of services to persons reliant on public health insurance programs can recruit and compensate their executive leadership without any regard to these regulations, while safety net organizations feel their full brunt—even though these organizations will still have to compete for healthcare executive talent against the rest of the healthcare industry.

Finally, members of our Section have also highlighted concerns over the revised regulations' redefinition of "related organizations" and the application of these requirements to subcontracting entities under certain circumstances. (1002.2(b) and 1002.3(d)). The regulations would appear to be potentially applicable to a host of entities whose only connection to the State of New York would be the fact that they do business with a covered provider. Extending these regulations to a host of otherwise unregulated entities would neither be consistent with the terms of the Executive Order nor a prudent use of limited state regulatory resources.

The use of a state-approved compensation survey: The revised regulations still do not provide the necessary certainty and predictability that complex health care organizations require in recruiting and retaining key executive leadership. We were particularly disappointed that the revised regulations did not materially alter the manner in which the comparability of executive compensation would be measured. Although the regulations will allow healthcare entities to use non-state funds to pay in excess of \$199,000 if the salaries are deemed to be below the 75<sup>th</sup> percentile of comparable, similarly situated executives, the regulations still envision that this comparability calculation will be made based on a "compensation survey identified, provided or recognized by the department and the director of the Division of the Budget." (1002.3(b)(a)) (emphasis added). No additional information has yet been supplied as to which surveys may receive the Department's or the Division of the Budget's seal of approval or how these compensation surveys will be selected, when their findings will be available as guidance to these entities or whether any surveys could accurately reflect the market for the specific executives in question.

It is, frankly, impossible to imagine that any compensation survey or surveys will be sufficiently comprehensive to offer the Department and the twelve other state agencies implementing this regulatory scheme with useful comparable information for the tens of thousands of covered executives employed by tens of thousands of covered entities in a wide variety of fields. Not-for-profit healthcare entities are subject to IRS regulations that require them to undertake very specific health plan-based comparisons in establishing appropriate levels of compensation for their key staff, based upon highly focused data often compiled by compensation consultants that focus on truly comparable positions within comparable organizations and that take into account the size and complexity of the organizations, their geographic locations and their costs of living.

Rather than devoting the necessary resources to the compilation of a state "recognized" salary data bank that would purport to apply to the tens of thousands of covered executives across thirteen state agencies, we would urge the Department to allow the covered entity, at least in the first instance, to submit the evidence upon which it relied in determining the comparability of the compensation accorded to the covered executive—evidence that the Department could, in appropriate cases, challenge or even disregard if it did not appear to be an accurate gauge of comparable compensation.

Another more technical element of the executive compensation portion of the regulations deserves additional mention. Even if the compensation is deemed to satisfy the 75<sup>th</sup> percentile test, the regulations require further that the executive compensation be "reviewed and approved

While the response to comments appeared to acknowledge that the use of a 75<sup>th</sup> percentile test was destined to diminish, over time, the level of acceptable compensation (as "outlier" compensation arrangements are reduced to the 75<sup>th</sup> percentile, thereby making every succeeding year's 75<sup>th</sup> percentile substantially lower), the solution offered in the regulatory response—"We anticipate that the agency will assess the impact on salaries, if any, on an ongoing basis and will make any necessary adjustments to the regulations accordingly"—does not actually solve the problem. See Assessment of Public Comment, IV. 1002.3(1) Limits on Executive Compensation.

by the covered provider's board of directors or equivalent governing body (if such body exists) including at least two independent directors or voting members." (1002.3(b)(b), emphasis added). In many instances, and consistent with IRS guidelines, governing boards of not-for-profit healthcare entities delegate the compensation review function to a properly constituted compensation committee, which undertakes the review and approval of the compensation of key employees. We would recommend inserting ", compensation committee" after "board of directors" and before "or equivalent" in the quoted sentence above to conform to this widespread practice.

The regulation of compensation paid for with non-state funds: Alternatively, the Department could avoid having to undertake the unnecessary and burdensome task of assessing the comparability of compensation by allowing entities to pay above the capped amount as long as no state funds or state-authorized funds are involved in supplementing salaries above the cap. The regulations could still require entities to satisfy the IRS-like guidelines for compensation, including the requisite board or committee involvement and the review of comparable salaries. In this manner, Department would not have to engage in the inherently intrusive, legally questionable and administratively burdensome effort of assessing the comparability of salaries that may be largely or entirely paid with non-state funds.

The administrative expense cap: The substance of the administrative expense cap was significantly clarified and, in our judgment, improved by clarifying that a range of expenses should properly be regarded as "program," rather than "administrative," expenses. Under the revised regulations, we are pleased that "travel costs to and from client residences, direct care supplies, public outreach or education or personnel training to facilitate program services delivery, information technology and computer services and systems directly attributable to program services, such as, for example, electronic patient records systems to facilitate improved patient care or computer systems used in program services delivery or documentation of program services provided, quality assurance and control expenses" have all been expressly added to the program "column." (1002.1(h)(1)(iii)). In addition, the revised regulations also explicitly include as program expenses those "property rental, mortgage or maintenance expenses" that are "made in connection with providing housing to members of the public receiving program services from the covered provider." (1002.1(h)(2)).

The proposed limits on administrative expenses remain, however, unnecessary and counter-productive. Virtually all contracting entities face payment and contract limitations that curb or cap administrative expenses. Even though the State will not achieve any appreciable savings through the application of the administrative expense regulations to covered providers, the providers and the Department will incur significant administrative costs solely to maintain compliance with the proposed regulations. The only impact of the administrative expense component of the proposed regulations will be, ironically, to increase unreimbursed administrative expenses, while at the same time placing additional and unnecessary burdens on an already understaffed and under-funded Department of Health.

Waiver process: In general, the revisions to the regulations appear to have been designed to facilitate the application for and receipt of waivers. Waivers may now be approved where a covered provider has "demonstrated good cause" (rather than "compelling circumstances") (1002.4(a)(3)) and we support the inclusion of the additional criterion that permits waivers from the executive compensation cap based on the "qualifications and experience possessed by the covered executive or required for the position." (1002.4(a)(2)(v)). Although these and other changes appear to signal a more liberal waiver process, it will be important that objective standards be established by which waivers may be granted to ensure fairness and predictability in the waiver process—and that entities have the opportunity to challenge the denial of waivers in a timely way that does not result in adverse consequences to the organization while it remains pending.

The various timing requirements on the waivers continue to be unworkable. The revised regulations now require the submission of waivers *ninety* (rather than sixty) days before the reporting period—and, in the case of new hires, before the position is filled. (1002.4(a)(1)(i) and (ii)). Requiring waivers to be filed even earlier than under the prior regulations and requiring the filing of a waiver before a person is hired is unrealistic—which may be why the revised regulations commendably allow the Department to consider untimely waiver applications for reasonable cause (1002.4(a)(1)(iii). Covered providers will not, however, even know whether they may be required to file for a waiver until the Department provides sufficient information on the state-authorized "comparability" survey to allow entities to determine whether their salaries fall below the 75<sup>th</sup> percentile—and, even after that information is made available, it may prove virtually impossible for an entity to confidently and easily ascertain how highly particular and unique salaries actually might be viewed on the salary schedules.

Finally, we urged in our comments on the initial regulations that waiver requests be exempted from the Freedom of Information Law (FOIL) (Public Officers Law, §84 et. seq.) to protect against the intrusion into personal privacy that would be caused by routinely disclosing the content of waiver applications. We were pleased that the regulations were revised to reference this issue. As drafted, however, the revised regulations purport only to protect information provided from disclosure under FOIL "to the extent that one or more of the exemptions contained in the Public Officers Law is applicable." (1002.4(a)(5)). Deeming waiver requests confidential only when they may already be otherwise shielded from FOIL accomplishes precisely nothing. Waiver applications should simply be made expressly confidential and not subject to FOIL.

Necessity for further deferral of the regulations' effective date: The Department and its sister State agencies should be commended for acknowledging that the regulations could not possibly be implemented as of January 1, 2013, particularly after the Administration went to the trouble of making substantial changes to the initial regulations. As noted above, implementation on April 1, 2013 is now equally untenable.

A conscientious provider recently contacted a member of the Section for guidance as to whether the provider should proactively apply for a waiver, even before the regulations have been finalized and without even knowing for certain that a waiver would be required. It is, of course, entirely possible that the executive compensation paid by that provider falls below the 75<sup>th</sup> percentile of comparable executives, thus obviating the necessity of a waiver. In the absence, however, of any information about the salary schedules that might be relied upon in assessing whether the salary falls below that threshold, the provider has no way of knowing whether the applicable executives' compensation might satisfy the regulations. At the same time, the revised regulations require the provider to apply for a waiver ninety days before the start of the reporting period or run the risk that the provider's waiver request would be denied as untimely.

Given the complexity of the executive compensation and administrative expense regulations, the absence of any information regarding the required reporting forms and requirements, the lack of details relating to the waiver process, the absence of any information on the "compensation survey" to be utilized by state agencies and a host of other implementation details, we would respectfully urge that the effective date of the regulation be delayed at least until January 1 or April 1, 2014.

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We appreciate the opportunity to comment on these regulations and would be happy to provide additional information relating to these comments if that would prove helpful to your consideration. If, as we hope, the Department makes any significant changes to the proposed regulations, we would strongly urge the Department to republish the revised regulations and initiate another comment period to ensure that there is a full opportunity to comment upon this potentially significant regulatory proposal.

Sincerely,

Ellen V. Weissman

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