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Medicaid Reimbursement and the State's
Treatment of Administrative Overhead Expense:
An Analysis of Recent Case Law

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Background

- Not-for-Profits that provide mission based healthcare services and receive state dollars, including Medicaid dollars, are held to a high level of scrutiny in terms of reimbursable costs.
- Reports emerged of high executive compensation within not-for-profit healthcare organizations funded in part by Medicaid, resulting in an investigation ordered by Governor Cuomo.
- In January 2012, Governor Andrew M. Cuomo issued Executive Order No. 38 to certain executive agency heads, including respondent Commissioner of Health, directing agencies providing state funding to service providers to regulate provider use of state funds for executive compensation and administrative costs.

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Background

- Hon. Andrew M. Cuomo's Executive Order No. 38:
 - Limits providers' allocation of state funds toward administrative costs to 15% by 2015.
 - Addresses the use of public funds to support excessive executive compensation and administrative costs among providers.
 - Directed each Executive State agency that provides State financial assistance or State-authorized payments to providers of services, including but not limited to the Office for People with Developmental Disabilities ("OPWDD"), Office of Mental Health ("OMH"), Office of Alcoholism and Substance Abuse Services ("OASAS"), Office of Children and Family Services ("OCFS"), Office of Temporary and Disability Assistance, Department of Health ("DOH"), Office for the Aging, Division of Criminal Justice Services, and Office of Victim Services to enact or amend regulations addressing state-funded administrative costs and executive compensation.

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Executive Order No. 38

- Restrictions on Administrative Expenses:
 - “No less than 75% percent of the State financial assistance or State-authorized payments to a provider for operating expenses shall be directed to provide direct care or services rather than to support administrative costs, as these terms are defined by the applicable State agency in implementing these requirements. This percentage shall increase by 5% each year until it shall, no later than April 1, 2015, remain at no less than 85% thereafter.”

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Executive Order No. 38

- Restrictions on Executive Compensation:
 - “To the extent practicable, reimbursement with State financial assistance or State-authorized payments shall not be provided for compensation paid or given to any executive by such provider in an amount greater than \$ 199,000 per annum, provided, however, that the commissioner of each agency shall have discretion to adjust this figure annually based on appropriate factors and subject to the approval of the Director of the Budget, but in no event shall such figure exceed Level 1 of the federal government's Rates of Basic Pay for the Executive Schedule promulgated by the United States Office of Personnel Management.”
 - 9 N.Y.C.R.R. 8.38 and 10 N.Y.C.R.R. 1002

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Matter of Chautauqua County Ch. of NYSARC

Inc. v. Delaney

58 Misc. 3d 1216(A) (Supreme Court, Chautauqua County 2018)

Decision Highlights

- The Resource Center is a non-profit, independently operated chapter of the New York Statewide Association for Retarded Citizens (“NYSARC, Inc.”) that serves individuals with developmental disabilities and other disabling conditions.
- Medicaid reimbursements finance many of these services.
- Respondents included the Commissioners of the Office for People with Developmental Disabilities (OPWDD) and the Department of Health (DOH) - governmental agencies that regulate Medicaid-financed programs.

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Decision Highlights

- Petitioner challenged the legality of the State's denial of its Medicaid reimbursement appeals.
- The specific Medicaid services at issue were: day habilitation services, supervised Individualized Residential Alternatives, respite services and family care program services
- Home and Community Based Services ("HCBS") waiver agreements between state and federal government are the primary mechanism for NY to provide Medicaid-funded, community-based, long-term care services to the developmentally disabled.

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HCBS Waiver

- Waiver in this context means that the State enters into an agreement to have services provided to developmentally disabled individuals in a manner different from the strict Medicaid regulatory scheme. So for the purposes of analysis, the HCBS waiver services are provided by an Agreement to waive out of the Medicaid regulations and instead have services funded through the waiver agreement between the State and the Federal government. This waiver is permitted under Section 1915(c) of the Social Security Act.
- The waiver system allows the delivery of a wider range of community-based services than strict Medicaid would allow and at a lower cost than Medicaid.
- The applicable waiver agreement between the State and the Federal Governments applicable to The Resource Center fact pattern was entered into in 2009. ("2009 Waiver Agreement"). The 2009 Waiver Agreement in virtually all respects analyzed in The Resource Center case remained identical in subsequent Waiver Agreements and/or amendments agreed to by the State and the Federal Government. Structurally, the waiver agreements are re-entered into in a five-year cycle.

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Costs Associated with Services

- Three areas of costs associated with programming:
 - **Operating costs** to operate programs for the special needs individuals served by the agency. These costs can vary greatly based upon the number of individuals served and the extent of disability of the individuals being served.
 - **Property costs** which are funded separately and were outside the scope of this case. However, note that administrative costs which are attributable to managing an agencies real properties are relevant as they are part of administrative overhead and therefore are included in the Executive Order No. 38 analysis.
 - **Administrative costs** which tend to be fixed costs, such as finance department, HR Department, Corporate Compliance required costs to run the voluntary agency.

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HIM-15

- The Court stated that State policies, including those regarding costs and reimbursement, should be consistent with federal requirements and with the 2009 Waiver Agreement.
- 14 N.Y.C.R.R. § 686.13(b)(ii)(d) provides, "except where specific rules concerning allowability of costs are stated herein, or in Subpart 635-6 of this Title, the Medicare Provider Reimbursement Manual, commonly referred to as HIM-15 shall be used to determine the allowability of costs as to nature and amount."

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HIM-15

“New York State regulations clearly provide that HIM-15 shall be used to determine the nature and amount of a service provider's allowable costs. HIM-15, in turn, requires that a service provider's actual and reasonable administrative costs are to be covered by states, like New York, participating in HCBS waiver programs.”

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HIM-15

- HIM 15 requires consideration of all reasonable indirect and direct costs of providers of services.
- The State Reimbursement System includes setting a “rate” which equates to the maximum reimbursement a service provider can receive during the course of a year.
- The rate is the amount charged to Medicaid for a unit of service to developmentally disabled individuals.

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HIM-15

- Administrative costs tend to be fixed costs necessary to provide quality services presuming a program is running at full occupancy.
- However, when vacancies occur- and many of these are attributable to the regulatory body not approving the filling of vacant slots, the “rate” will not be sufficient to fund all administrative costs.

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The Court's Analysis

- The Court rejected that DOH/OPWDD assertion that it would never fund and did not need to fund administrative shortfalls through vacancy appeals.
- DOH/OPWDD policies and methodology which sought to deny The Resource Center's vacancy appeals for reasonable administrative costs were described by the court as “**little more than bureaucratic fiat**”.

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The Court's Finding

- The rejections of the vacancy appeals was found to be made in an arbitrary and capricious manner and the determinations unlawful.
- The finding, supported specifically by the court's language establishes that DOH/OPWDD need to consider actual and reasonable costs of providing services to developmentally disabled individuals.

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LeadingAge New York, Inc. v. Shah

2018 NY Slip Op. 06965 (October 18, 2018)

Decision Highlights

- Petitioner provides services to people in nursing homes, assisted-living programs, home-care agencies, and trade associations representing those types of providers.
- Petitioner contracts with DOH to provide healthcare services and receives significant state funds primarily via Medicaid.
- Petitioners sought invalidation of the regulations, contending that in promulgating the regulations, DOH exceeded its regulatory authority and violated the separation of powers doctrine; and asserted that the regulations are arbitrary and capricious.
- Substantive due process and federal preemption claims.

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“Hard” and “Soft” Caps

- Two of the regulations have been labeled a "hard cap" (*id.* 1002.2[a], 1002.3[a]) and the third a "soft cap" (*id.* 1002.3[b]). The hard cap has two components, one relating to administrative expenses and the other executive compensation. The administrative expenses hard cap mandates that "[n]o less than 75 percent [increasing to 85 percent by 2015] of the covered operating expenses of a covered provider paid for with State funds or State-authorized payments shall be program services expenses rather than administrative expenses," thus limiting the percentage that the provider may allocate to administrative expenses to 15% beginning in 2015 (*id.* 1002.2[a]). The executive compensation hard cap directs that, absent a waiver, a covered provider may "not use State funds . . . for executive compensation . . . in an amount greater than \$199,000" (*id.* 1002.3[a]).
- The "soft cap" regulation relates to executive compensation. Under the soft cap, a covered provider is subject to penalties if executive compensation exceeds \$199,000 per year from any source of funding (state or non-state), with two significant exceptions (*id.* 1002.3[b]). The soft cap is applicable only if the executive compensation either (i) is "greater than the 75th percentile of that 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] and the Director of the Division of the Budget"; or (ii) "was not reviewed and approved by the covered provider's board of directors or equivalent governing body (if such a board or body exists) including at least two independent directors or voting members" (*id.*).

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The Court's Finding – Soft Cap

- Chief Judge DiFiore wrote the opinion affirming the determination of the Appellate Division Third Department that the “soft cap” on executive compensation in the DOH regulations was not a proper exercise of the agency’s powers and that it illegally intruded “on the legislative prerogative to make policy choices about overall executive compensation from sources beyond taxpayer funds.”
- DOH was “improperly engaged in acting on its own ideas of good public policy.”
- “The need to control the compensation of executives in various types of corporations, particularly not-for-profit corporations, is increasingly the subject of debate. That debate involves weighing difficult public policy goals, and is not necessarily connected to the corporation’s reliance on taxpayer funding.”
- DOH “overstepped its statutory authority by setting a ‘soft cap’ on executive salaries paid from all sources and defining the criteria and decision-making processes that must be applied before corporate entities may exceed the ‘soft cap.’”

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The Court's Finding – Hard Cap

- An administrative regulation stands as long as it "has a rational basis and is not unreasonable, arbitrary or capricious"
- The discovery of excessive executive compensation within the health care industry provided a rational basis for the hard caps, as did New York's rapid increase in health care spending, resulting in per capita Medicaid spending nearly twice the national average.
- “We cannot say that it was irrational for DOH to promulgate regulations that direct public funds towards services and away from non-service-provider salaries and administrative overhead, as well as to permit waivers on a case-by-case basis when a covered provider establishes that higher executive compensation or administrative expenditures are necessary to deliver quality services to the public. Accordingly, petitioners' challenges to the hard cap regulations were properly rejected.”

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The Dissents

- Judge Garcia found that both the soft and hard caps on executive compensation were beyond DOH's constitutional authority.
 - “ A policy choice about reasonable executive compensation aimed at influencing corporate behavior is lawmaking beyond DOH's regulatory authority.” Slip Opinion at *12.

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The Dissents

- Judge Wilson disagreed that the soft cap is invalid.
 - “... just as the hard cap objectively advanced the legislatively-circumscribed goal of getting the ‘biggest bang for the buck’ in its Medicaid services, the soft cap, which is really just an anti-circumvention provision, does the same.” Slip Opinion at * 20.

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*Concerned Home Care Providers, Inc. v. NYS Department
of Health*

2018 NY Slip Op. 06965 (October 18, 2018)

Decision Highlights

- Companion case to *LeadingAge* addressed on Judge DiFiore's opinion.
- Petitioners were the Coalition of New York State Public Health Plans, New York State Coalition of Managed Long Term Care/PACE Plans, and New York Health Plan Association, Inc.
- Petitioners were trade associations representing health-care plans, health maintenance organizations, and long-term care plans.
- Petitioner contract with DOH to provide healthcare services and receive significant state funds, primarily via Medicaid.

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Decision Highlights

- Petitioners sought invalidation of the regulations, contending that in promulgating the regulations, DOH exceeded its regulatory authority and violated the separation of powers doctrine. Petitioners further asserted that the regulations are arbitrary and capricious.
- Court of Appeals Upheld the constitutionality of Executive Order 38 as consistent with legislative policy.
- “The Appellate Division correctly held that the hard cap regulations were a proper exercise of DOH's regulatory powers.”

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Thank You

QUESTIONS

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