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**Legal Alert: After Court Ruling, Nonprofits Covered by Executive Order 38 Can Use
Non-State Funds for Executive Compensation Over \$199,000**

State agencies have started issuing amended regulations to comply with a year-old New York State Court of Appeals decision declaring unconstitutional Executive Order 38's (EO38) "soft cap" provision, which limited the compensation that nonprofit recipients of state funds could pay their executives.

What is EO38?

Governor Cuomo issued EO38 in 2012, instructing state agencies to limit both the compensation that entities receiving significant amounts of state funding could pay to their executives, and the administrative costs that state funding could cover. Thirteen different state agencies then issued regulations to implement Governor Cuomo's order.

What Did the Court Opinion Change?

One part of EO38 is a "soft cap" on nonprofit state contractors' executive compensation. Under this soft cap, a covered nonprofit could not pay a covered executive more than \$199,000 annually, unless the Board either: a) determined that the executive's compensation was within the 75 percent of compensation paid to similar executives at similar organizations, or b) received a waiver from the State.

In October 2018, the New York State Court of Appeals struck down the soft cap as unconstitutional.¹ The court held that the state agencies that had issued regulations implementing EO38 had acted outside of the authority granted to them by the legislature, and had consequently violated the separation of powers protected by the state constitution.

The Department of Health and other state agencies have now started issuing regulations repealing the soft cap.² While these regulations are still in draft form, they show that the State is finally taking steps to comply with the court order.

Why Are Parts of EO38 Still in Effect?

While the soft cap is no longer in place, two other parts of EO38 remain in place: the "hard cap" on executive compensation, and limits on administrative costs.

Under the hard cap, a covered provider cannot use more than \$199,000 in State funds for executive compensation unless the nonprofit obtains a waiver from the State. That hard cap remains in place.

¹ *Matter of LeadingAge v. Shah*, 32 N.Y.3d 249 (2018).

² See, e.g., NY State Register, Nov. 13, 2019, p. 17 (proposed amendment to Office of Temporary & Disability Assistance EO38 regulations); NY State Register, Sep. 24, 2019, pp. 24 (proposed amendment to Department of Health's EO 38 regulations), 33 (proposed amendment to Office of Victim Services' EO 38 regulations).

Under the limit on administrative expenses, covered providers must use at least 85 percent of operating expenses paid for with State funds to cover program expenses. This means that up to 15 percent of operating expenses paid for with State funds can be used for administrative expenses.

Which Nonprofits Are Covered by EO38?

A nonprofit is covered if it receives on average more than \$500,000 yearly from one or more of 13 New York State agencies, either directly or through an agreement with another state or local entity or other organization. The payments must be in exchange for services (providers of pharmaceuticals and other goods are exempted). In addition, the nonprofit organization must receive at least 30 percent of its annual in-state revenues from the State.

What Nonprofits Should Do Now:

1. Determine if you are a covered provider. The state has provided a form for organizations to use to determine if EO38 applies to them or not. The Covered Provider Determination application is available online at: <https://www.eo38.ny.gov/xo/determinationForm>
2. If you are a covered provider, although you may now pay executives in excess of \$199,000 using non-State funds, you must continue to submit EO38 reports annually, demonstrating compliance with the hard cap. This means you should:
 - ensure that state funds do not represent more than \$199,000 of executive compensation;
 - ensure that you do not use more than 15 percent of state funds for administrative expenses; and
 - submit an application for a waiver if your organization cannot meet either of the above requirements.

The state has provided a guide for more detailed questions about the EO38 reporting obligation and applications for waivers:

https://executiveorder38.ny.gov/sites/default/files/documents/EO_38_Executive_Summary.pdf

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