

To: Clients and Friends

From: Manatt, Phelps & Phillips, LLP

Date: December 7, 2009

Subject: Summary of Enacted Deficit Reduction Proposal

On December 2nd, after a prolonged legislative stalemate, the New York State Assembly and Senate passed a revised version of Governor David Paterson’s Deficit Reduction Proposal (“DRP”), which, taken together with a series of administrative actions that have or will be taken by the Governor, will reduce State expenditures during the current year by approximately \$2.7 billion.

Even with these actions, the Governor sharply criticized the Legislature for not taking further steps to close the approximately \$3.2 billion current year deficit—which Comptroller Thomas DiNapoli recently stated may actually exceed \$4 billion—and for failing to extend these savings into the next fiscal year (commencing April 1, 2010), when the estimated deficit is likely to approach \$7 billion. He has also warned that he might be required to take additional steps to address the current year deficit, including directing the Division of the Budget (“DOB”) to “reduce State aid payments administratively in order to balance the budget and prevent New York from running out of cash.”

Several legislators have questioned the constitutionality of such action, citing the New York State Court of Appeals decision in County of Oneida v. Berle, 49 N.Y.2d 515 (1980), in which the Court held that “no authority inheres in the Governor under the State Constitution to impound funds appropriated by law.” In response, the Governor notes that the appropriations in question are all explicitly conditioned on the issuance of a “certificate of approval” by the Director of the Budget – thus, he need not honor an appropriation absent such a certificate, or, more precisely, he need honor one only to the extent that it is authorized by such a certificate. In response, Senator Eric Schneiderman has noted that certification by the Director of the Budget is a mere “ministerial act” and does not afford either the Director or the Governor the authority to refuse to spend appropriated funds. The Court in County of Oneida found that similar conditional language – providing that appropriations be made “as approved by the director of the budget” – did not allow the Governor to refuse to honor appropriations. In any case, any quasi-“impoundment” action by the Governor will almost certainly result in another court review of the breadth of the Governor’s budgetary authority.

In addition to the DRP, the Legislature passed sweeping reforms of New York’s public authorities, added a new tier to the State’s pension system and debated legislation that would have authorized same sex marriages in New York State—the latter of which was again passed in the Assembly, but was defeated in the Senate by a 38-24 vote.

The balance of this memorandum reviews the DRP expenditure reductions and summarizes the impact they will have on New York State programs and services, particularly throughout the health, human services, cultural and education sectors.

Health and Medicaid: While the DRP enacted a far less drastic set of reductions in the health care arena, health care and Medicaid-funded services still face significant cuts, including the following:

- *Trend factor elimination:* The DRP eliminates the usual annual trend factor for general hospital, nursing home and home care rates, which are otherwise subject to an inflationary increase, effective January 1st. However, the bill only eliminates the 2010 trend factor for the remaining portion of this fiscal year (1/1/2010-3/31/2010), thereby leaving the trend factor for the balance of 2010 to be debated as part of the Budget for the next fiscal year. (As usual, the reduction does not apply to hospice, nor to free-standing diagnostic and treatment centers, which are subject to different provisions). For hospital inpatient rates, this means the rates under the State's new inpatient rate-setting system, set to begin December 1, 2009, will be the same rates in 2010 (at least until 3/31/2010). The elimination of these trends will result in a \$11.5 million state share savings. At the same time, the DRP re-estimated certain health care costs, taking advantage of a further \$9.5 million state share savings.
- *No new or increased assessments, taxes or HCRA surcharges or other rate reductions:* Although consideration had been given to impose an increase in assessments on hospitals, home care agencies and nursing homes, no new or increased taxes, assessments or surcharges have been imposed. Further across the board Medicaid rate reductions that had also been advanced by the Governor that would have been compounded by the loss of the State's currently enhanced federal Medicaid share were also not included in the DRP.
- *Managed care premiums:* Similarly, although consideration was given to reducing managed long term care and PACE premiums, the final DRP does not include any reductions during the current state fiscal year to premiums paid to Medicaid managed care, managed long term care, or PACE plans.
- *Child Health Plus:* The final DRP includes a reduction in the amount of funds allocated for the Child Health Plus program. The 10% reduction reflects a take-back of unspent funds and not a direct reduction to plan premiums. Unspent funds are essentially being used as savings.
- *Medicaid managed care quality incentives:* The Department of Health will reduce the pool of funding in 2009-2010 for the Medicaid managed care quality incentive program by \$13.5 million. This represents a 20% reduction in the total pool and a savings of \$5.4 million to the state. As this cut is being done administratively, the Department is currently evaluating its impact and has yet to announce how this reduction will ultimately be implemented.
- *Medicaid Pharmacy and Elderly Pharmaceutical Insurance Program (EPIC) reimbursement:* The Department of Health will administratively reduce Medicaid pharmacy and EPIC reimbursement by \$18.5 million to account for the recently-approved settlement in New England Carpenters Health Benefit Fund, Inc. v. First Databank, Inc. In that case, First Databank—which establishes the average wholesale price (AWP) of pharmaceuticals upon which Medicaid and EPIC reimbursement is based—was alleged to have conspired with a

pharmaceutical wholesaler to improperly increase those published AWP. Effective September 26, 2009, First Databank—without admitting any wrongdoing—has agreed to reduce the reported AWP for certain drugs by 4%, and plans to cease publishing AWP within two years.

- *Authorizing registered nurses to provide a 15-day, rather than an 8-day, supply of prescription medicines to home care patients:* Accepting a proposal advanced by the home care industry, the DRP directs the Commissioner of Education, in consultation with the Boards of Nursing and Pharmacy, to promulgate guidelines allowing for the prefill of up to a fifteen day supply of prescription medication—a step that will lessen the frequency of nursing visits and is estimated to result in a \$2.7 million state savings.
- *Delaying HEAL NY payments:* The DRP allows the Commissioner of Health and the Budget Director to delay payments under the State’s HEAL grant program until either April 1, 2010 or the adoption of the 2010-2011 budget, whichever is later. Prompt payment and other requirements are waived to accommodate this “cash management” of HEAL expenditures, which is expected to reduce State expenditures by \$45 million.
- *Increased Medicaid Fraud targets:* The DRP contemplates that the Office of the Medicaid Inspector General (“OMIG”) will recover \$150 million in fraud recoveries than had already been contemplated during the final months of this fiscal year.

State Aid to Education: The Governor had proposed to reduce state support for schools through a mid-year across the board reduction in State Aid, resulting in \$480 million in State savings in this fiscal year, which reflected a 4.5 percent reduction in the remaining, undisbursed payments during the current fiscal year. Instead, the DRP accelerates the use of \$391 million in federal stimulus funding to close the deficit, effectively “borrowing” what had been anticipated to be used during the 2010-2011 school year.

In addition to certain local assistance grant programs noted below, the education sector again saw reductions in state support for higher education:

- Bundy Aid was reduced by over \$1.8 million;
- Higher Education Opportunity Program was reduced by over \$2.8 million;
- Community College Base Operating and Rental Aid was reduced by \$17.4 million; and
- An additional \$53 million was cut from CUNY operations.

Member Item Funding: Due to the prolonged Senate power struggle at the end of session, the Senate did not pass a resolution identifying so-called “member items” for a range of different programs and services until this Fall—a resolution that required Assembly passage, which was not forthcoming until the DRP negotiations concluded. Rather than pass the Senate resolution as had been contemplated by the 2007 Budget Reform statute, the DRP appropriation bill contained a provision that “notwithstanding” the budget reform statute and enacted the Senate member items in a lump sum, subject to a 12.5% reduction from the previously established \$85 million. The Senate is required to prepare a list of grantees that totals \$74,375,000 and submit the list to the Senate Finance Committee by January 15th, 2010. The

list of grantees is then subject to the approval of the Budget Director. While most of the Assembly Majority member items were detailed in the April 2009 enacted budget (approximately \$65 million), similar language was included in the DRP that reduced the balance of remaining Assembly Majority member item funding from \$20 million to \$9,375,000—which reduces State Assembly member items by the same amount as Senate member item funding was cut.

Other “one-shot” budget savings: The DRP included a number of other so-called “one shots” (non-recurring revenue increases or spending decreases) that the Governor had proposed. These items included:

- ***Tax amnesty:*** The State will forgive certain penalty and interest on long-outstanding State tax liabilities, expected to generate \$250 million during the last quarter of this fiscal year.
- ***Environmental program “raids”:*** The DRP transfers \$90 million from the Regional Greenhouse Gas Initiative (“RGGI”) account and \$10 million from the Environmental Protection Fund to the State’s General Fund.
- ***Dormitory Authority of the State of New York (“DASNY”) transfer:*** Likewise, \$26 million from DASNY is transferred to the General Fund.
- ***Battery Park City Authority (“BPCA”):*** The DRP authorizes the transfer of \$200 million from BPCA to the General Fund.
- ***Aqueduct Video Lottery Terminals (“VLTs”):*** The DRP anticipates that a franchise payment of \$200 million by the winning bidder for the operation of the VLTs at the Aqueduct race course will be made by April 1, 2010.

Local Assistance Reductions: The Governor had advanced a proposal to cut local assistance expenditures across the entire gamut of state government by reducing the undisbursed balance of these funds, as of November 1, 2009, by 10%. In lieu of the Governor’s proposal, the DRP reduces a somewhat more selective set of local assistance expenditures by 12.5%. These reductions affected local assistance funding by nearly every state agency and totaled over \$500 million in state savings. One of the few state agencies that dodged these otherwise across-the-board reductions was the State Office for the Aging (SOFA), whose programs were not subject to any DRP reductions.

Because the amount of the reduction is calculated on the basis of 12.5% of undisbursed funds, it is not possible to calculate the actual reduction in spending without knowing how much has actually been disbursed in each of these programs—an amount known only to the state agency and DOB, and not reflected in the appropriation bill language. Thus, the estimates of impact, described below, are based on estimates released by DOB—some of which have been questioned by persons familiar with individual programs.

The following summarizes some of the key elements of these local assistance reductions:

Health and Aging. The Governor's office reported a total of \$41.2 million cuts to health care and aging programs outside of Medicaid. On top of the reductions noted below, the DRP reduced disease management programs from \$4.7 million to \$1.91 million. Programs subject to the 12.5% reduction of funds not disbursed as of November 1, 2009, and the estimated reduction amounts, include the following

Department of Health

- Public hospital worker recruitment and retention: \$975,000
- Workforce retraining program: \$3,146,000
- Tobacco Cessation Programs: \$2,188,00
- Anti-Tobacco Roswell Research: \$906,000
- Roswell Park Cancer Institute research: \$4,775,000
- Rural Health Care Access Development: \$566,000
- Rural Health Network Development: \$250,000
- Cancer Initiatives: \$1,346,000
- School-based Health clinics: \$1,200,000
- Poison control centers: \$301,000
- Access to infertility services, treatments and procedures: \$324,000
- Uniform assessment program: \$194,000
- Traumatic Brain Injury services (including HCBS services): \$533,000
- Graduate Medical Education Programs: \$2,364,000

The following programs are also subject to the 12.5% reduction, although DOB has not provided the estimated reduction amounts:

- NYS Health Education Center program
- Ambulatory care training program
- Physician loan repayment program
- Physician practice support program
- Physician workforce studies
- Diversity in medicine/post baccalaureate program

The DRP reduces state funding and grants for the following HIV/AIDS prevention and education programs by 12.5% of funds not disbursed as of November 1, 2009:

- Existing community service programs serving minority and high risk populations: \$204,000
- Maternal and child HIV services: \$265,000
- The New York/New York III Supportive Housing Program: \$174,000

The following HIV/AIDS prevention and education programs are also subject to the 12.5% reduction, although DOB has *not* provided the estimated reduction amounts:

- Education, prevention and nutritional services including services for individuals homebound with AIDS in adult day care or home care settings.
- The cost of living adjustment for certain HIV/AIDS service providers.

Funding and grants for the following community health programs and services are subject to reduction by 12.5% of funds not disbursed as of November 1, 2009:

- Nutritional services: \$265,000
- Nutritional education for pregnant women, infants and children (WIC): \$1,378,000
- The Hunger Prevention and Nutrition Assistance Program (HPNAP): \$1,198,000
- Breast cancer detection: \$175,000
- Red Cross emergency response preparedness: \$179,000
- Health promotion initiatives: \$179,000
- The Public Health Campaign for tuberculosis control and prevention: \$279,000
- Grants and funding for statewide emergency contraception outreach, education, and training services: \$200,000

The following community health programs are also subject to the 12.5% reduction, although for most of the programs DOB has not provided the estimated reduction amounts:

- Education and screening for sexually transmitted diseases.
- Migrant worker services.
- OTDA and disability assistance for prenatal care program activities.
- The cost of living adjustment for certain community health service providers.

Finally, in the Center for Environmental Health Program, the DRP reduces funding for the Water Supply Protection Program by \$219,000.

Mental Hygiene. The Governor's office reported a total of \$112.5 million in cuts to mental hygiene programs, including cuts affecting programs funded by the Office of Mental Retardation and Developmental Disabilities (OMRDD) and the Office of Alcoholism and Substance Abuse Services (OASAS) as well as the Office of Mental Health (OMH). On top of the reductions noted below was a \$19.4 million reduction in the subsidy provided to small business health insurance coverage for providing broad based insurance coverage for mental health services, in accordance with Timothy's Law—a reduction DOB reported at \$10 million.

In an unusual move, the final budget agreement cut deeper into OMH and OASAS than the Governor's original proposal. Both OMH and OASAS are reporting that they have worked with DOB to allow them to have sufficient flexibility to make transfers of funds within their budgets to "manage their way through the cuts," apparently by managing cash outlays and by slowing new programs. However, given the size of these reductions, we assume the agencies will be hard-pressed to mitigate program and service reductions.

The cuts include:

Office of Mental Health

- Reductions in a host of adult services programs, including certain non-residential programs (funded through community support services programs and local and unified services plans), comprehensive psychiatric emergency programs, disproportionate share payments to non-profit general hospitals, the Assisted Outpatient Treatment program (mandated by Kendra's Law), various community mental health residential programs (excluding debt service reimbursement) and other adult programs: \$45.8 million.
- Children's mental health services, including similar non-residential programs, disproportionate share payments, and mental health emergency programs: \$11.6 million.
- Community mental health support and reinvestment funding: \$430,000.

Office of Alcoholism and Substance Abuse Services: The DRP cut 12.5% of unspent funds for outpatient services, residential services, crisis services, as well as services directed to problem gambling, which represents a savings of approximately \$19.3 million.

Office of Mental Retardation and Developmental Disabilities: The reductions to OMRDD programs were considerably less than had been first proposed in the Governor's version of the DRP. The cuts remain substantial, but were pegged at a 10% reduction, as the Governor had proposed, and were not raised to the 12.5% reduction level many other programs sustained. The overall impact is estimated to be \$35.2 million.

Human Services. The Governor's office reported a total of \$18.1 million to social service programs comprising the Office of Children and Family Services, the Office of Temporary and Disability Assistance, Division of Housing and Community Renewal and the Department of Labor. Programs subject to the 12.5% reduction of funds not disbursed as of November 1, 2009, and estimated reduction amounts, include the following:

Office of Children and Family Services

- Medical care for foster children: \$4.25 million
- Preventive services: \$329,000
- Youth Development and Delinquency Programs/Special Delinquency Prevention Program: \$2,620,000
- Runaway and Homeless Youth: \$506,000
- Home Visiting: \$1,508,000
- Advantage After School: \$2,397,000
- Child abuse investigation teams and child advocacy centers: \$448,000
- Local district training: \$180,000

Office of Temporary and Disability Assistance

- Homelessness Prevention: \$295,000
- Supportive service subsidies for SRO housing: \$1,373,000
- EBT system: \$982,000
- Local district administrative cap waiver requests: \$551,000

Civil Legal Services. Programs subject to the 12.5% reduction of funds not disbursed as of November 1, 2009, and estimated reduction amounts, include the following:

- Civil legal services (\$4,241,911 Assembly legislative add in the Department of State budget): \$246,000
- \$25,000,000 Subprime Foreclosure Prevention Services Program appropriation: \$3,125,000

Other areas. The following programs also receive a 12.5% decrease in funding under the DRP:

Division of Parole

- Treatment, residential stabilization and related services for offenders in the community: \$78,000

Council on the Arts

- Grants for programs and activities relating to art disciplines: \$384,000

Education Department

- Competitive grants for Adult Literacy/Education Aid to public and not-for-profit agencies: \$306,000
- Extended Day and School Violence Programs: \$3,478,000
- Aid to Public Libraries: \$4,219,00
- Summer school special education: \$13,005,000
- Private schools for the blind and deaf: \$8,288,000

Division of Housing and Community Renewal

- As noted above under Civil Legal Services, the Subprime Foreclosure Prevention Services Program: \$3.125 million
- Assistance to not-for-profit housing companies: \$123,000

Insurance Department

- Administration of the cervical cancer vaccine program: \$1.7 million
- Childhood Lead Poisoning Primary Prevention Program: \$96,000
- Administration of the Immunization Program: \$140,000

- Services and expenses related to Healthy NY: \$3 million

Given the Governor's apparent intention to make additional unilateral reductions in state spending, we will, of course, be monitoring any additional deficit reduction activity very closely. And, in only slightly more than a month, the Governor is expected to release his 2010-2011 State Budget, which is certain again to propose deep reductions in state spending across the board. If you have any questions regarding the DRP or require any additional information on any other matter, please contact Manatt, Phelps & Phillips, either in Albany (518-431-6700) or in New York City (212-790-4500).