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Best Practices for Developing Stark Compliant Timeshare Leasing Arrangements

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Since the Centers for Medicare & Medicaid Services (CMS) released its voluntary Stark Self-Referral Disclosure Protocol (SRDP) on September 23, 2010, noncompliant leasing arrangements have already contributed to several published self-disclosures. While CMS indicates that hundreds of self-disclosures have been filed, few have been settled to date. Due to the technical requirements and operational challenges imposed on leasing arrangements, it is likely that noncompliant leasing arrangements will result in a significant number of self-disclosures.

Timeshare leasing arrangements are not new to the healthcare industry. However, over the past decade, CMS has become increasingly skeptical of the concept of timeshare arrangements. This skepticism has caused CMS to carefully analyze these arrangements. This has resulted in CMS promulgating additional regulatory requirements for timeshare leasing arrangements that are not generally imposed on full-time leasing arrangements. The technical nature of the regulatory requirements and administrative challenges imposed on these arrangements make them a potential compliance risk for providers.

For those who do not typically handle leasing arrangements between providers, it may help to provide an example of how timeshare arrangements are typically structured. Imagine that a rural hospital does not have an orthopedic specialist who practices in the community. In response to community need, the hospital asks an orthopedic physician from a neighboring community to operate an orthopedic physician clinic at the hospital. The physician agrees to provide services for two days each week during each calendar month. To accommodate the physician, the hospital offers to lease space to the physician in its medical office building on Mondays and Tuesdays from 9 a.m. to 5 p.m. Under the leasing arrangement, the hospital will provide the physician with a turn-key medical office suite that is fully furnished and operational. The physician does not need to make any improvements to the space or to bring any medical or office supplies in order to begin seeing patients. The timeshare leasing arrangement allows the physician tenant to lease space at the hospital on a part-time or timeshare basis, as opposed to a full-time or traditional leasing arrangement. Timeshare arrangements reduce costs for the physician and allow the hospital the flexibility of renting what might otherwise be unused medical office space to other specialists.

While timeshare leasing arrangements serve an important purpose, the hospital landlord in our example may encounter a number of practical challenges in administering a compliant timeshare arrangement. Beyond the standard elements found in most of the Stark Law exceptions and Anti-Kickback Statute safe harbors, such as written agreements signed prospectively by the parties, timeshare leasing arrangements require continuous administrative oversight of occupancy schedules and accounting for services or supplies offered to the tenant during scheduled use periods.

This article highlights some of the practical difficulties in developing compliant timeshare leasing arrangements, in part, by identifying common themes arising from the few published self-disclosures involving noncompliant leasing arrangements. This article also offers suggestions for best practices in establishing a Stark-compliant timeshare leasing program. In particular, it provides recommendations to address the following operational challenges: (1) defining the space to be leased; (2) establishing an occupancy schedule; (3) identifying the services offered to the tenant; and (4) setting a fair market value rental rate.

Regulatory Framework

A number of federal fraud and abuse laws affect timeshare leasing arrangements, including the Stark Law and the Anti-Kickback Statute. This article is focused primarily on the Stark Law because its regulations affecting timeshare arrangements are more stringent than the regulations under the Anti-Kickback Statute. Nevertheless, any timeshare leasing arrangement should be structured to comply with the Stark Law and the Anti-Kickback Statute, and CMS has promulgated regulations under both that apply to timeshare leasing arrangements. Those regulations and commentary interpreting those regulations should serve as guidance for counsel structuring timeshare leasing arrangements.

The Stark Law

To the extent that the Stark Law applies to a timeshare leasing arrangement, the parties should structure the arrangement to meet the rental of office space exception. This exception allows payments for the use of office space made by a tenant to a landlord if the leasing arrangement meets the following requirements:

1. the lease is set out in writing, signed by the parties, and specifies the premises covered by the lease;
2. the space rented does not exceed that which is reasonable and necessary for the legitimate business purposes of the lease and is used exclusively by the lessee when being used by the lessee, except that the lessee may make payments...
Due to the technical requirements and operational challenges imposed on leasing arrangements, it is likely that noncompliant leasing arrangements will result in a significant number of self-disclosures.

Commentary from CMS interpreting the rental of office space exception provides additional guidance on timeshare leasing arrangements. For example, in Phase IV of the Stark Law, CMS prohibited “on-demand” leasing arrangements and further distinguished between per-click and block leases. As a result, the hospital and physician in our example must establish a fixed schedule of times in which the leased premises will be leased by the physician. The leasing arrangement must also be structured so that the physician leases a block of time (e.g., a use period no less than four hours long) instead of short periods of time (e.g., one-hour use periods).

The Anti-Kickback Statute
Under the Anti-Kickback Statute, space leasing arrangements between regulated parties are prohibited unless the arrangement meets one of the statute’s safe harbors. A commonly used safe harbor for leasing arrangements is the space rental safe harbor. It provides that remuneration (kickbacks, bribes, or rebates) does not include any payment made by a tenant to a landlord for the use of premises, so long as certain requirements are met. The requirements in the space rental safe harbor are similar to the requirements set forth in the Stark Law rental of office space exception. The only material difference is that the text of the space rental safe harbor requires any timeshare arrangement “specify the schedule of such intervals, including their exact length and rent for such interval.” CMS commentary under the Stark Law rental of office space exception discusses similar requirements, although they have not been codified into any regulation.

Additional guidance on how the Anti-Kickback Statute space rental safe harbor applies to timeshare arrangements can be found in a Special Fraud Alert (the Fraud Alert) published by the Office of Inspector General (OIG), the investigatory body of the Department of Health and Human Services. In the Fraud Alert, the OIG states that any timeshare leasing arrangement will be suspect if rent is charged by the hour, but the lease does not fix the number of hours or the schedule of usage in advance.

Due to the fact that provider services and ownership of provider entities change over time, timeshare leasing arrangements between healthcare providers should always be designed to comply with both the Stark Law and Anti-Kickback Statute regulations discussed above.

Challenges and Best Practices
Administering timeshare leasing arrangements can be challenging. The remaining part of this article outlines areas that present potential risks for the landlord and tenant, along with recommendations for developing a series of best practices for timeshare leasing arrangements.

Defining the Leased Premises
One of the challenges of structuring timeshare leasing arrangements is defining the space to be leased. As an illustration, assume that the physician in our example wants the right to lease space on a part-time basis within an existing medical office suite that consists of approximately 3,000 square feet. The medical office suite contains more space than is necessary for the physician’s intended use of seeing a few patients two days per week. Historically, physicians in this situation have requested that the leased premises be reduced to the smallest common denominator. For example, it is quite common for the tenant to request one or two examination rooms that will be exclusively used during scheduled times, together with the non-exclusive right to use in-suite common areas, such as a waiting room, receptionist area, nurses station, and interior hallways. The physician typically does not want to lease the entire suite because of the carrying costs associated with the entire suite.
The depiction of the medical office suite set forth above illustrates the space the tenant would like to lease.

One question raised by legal counsel in these situations is to what extent are the landlord and tenant permitted to limit the leased premises to a fractional amount of space within a larger medical office suite? This question can be difficult to answer at times. It often leads to a second question from counsel as to whether the arrangement will satisfy the Stark Law rental of office space exception and Anti-Kickback Statute space rental safe harbor. Under the laws, the parties are prohibited from leasing more space than is "reasonably necessary" for a legitimate business purpose. But, in this hypothetical, the space does not exceed that which is reasonably necessary for a legitimate business purpose. In fact, it is quite the opposite.

If the space to be leased does not exceed that which is reasonably necessary for the legitimate business purpose, then what portion of the medical office suite must be leased on an "exclusive" basis and what portion of the suite can be shared? Fortunately, CMS has provided some guidance on this question. In the final rules for Phase III of the Stark Law, CMS stated that by common areas CMS means "foyers, central waiting rooms, break rooms, vending areas, etc.” CMS was clear that examination rooms should not be considered "common areas.”

The commentary provided by CMS on what space should be treated as exclusive space versus non-exclusive space or common areas is helpful to a certain extent. However, it does not give the landlord and tenant the right to reduce the leased premises to the smallest common denominator. Instead, counsel for both the landlord and tenant should be guided by the underlying Stark Law requirement that the arrangement be structured in a manner that is "commercially reasonable" even if no referrals were made between the landlord and tenant. This standard requires the landlord and tenant to ensure that the leasing arrangement is structured as an arms-length transaction.

To ensure that the leasing arrangement is commercially reasonable and compliant with the Stark rental of office space exception and Anti-Kickback Statute space rental safe harbor, the landlord should engage a space planner or architect to measure the entire medical office suite. Defining the amount of space within the suite is important since it is a factor when determining if the amount of rent to be paid under the leasing arrangement is fair market value. This is particularly true because, in most cases, appraisers and commercial real estate brokers establishing fair market rental rates often provide a fair market rental rate on a per square foot basis. It is also important from a business perspective to ensure that the landlord is covering its carrying costs for the space.

Because measurement methodologies vary, counsel for the landlord should work with the architect or space planner to agree upon a measurement methodology that is applied consistently throughout the building. For purposes of measuring office space, most medical office landlords elect to use a measurement standard approved by the Building Owners and Managers Association (BOMA), although other measurement methodologies may be appropriate for a particular geographic location. Healthcare providers often prefer BOMA standards because they are often employed by institutional real estate owners and investors, which supports the case that the provider’s approach is commercially reasonable.

Once the space has been measured, counsel for the landlord and tenant will need to define the in-suite common areas that support the space being used on an exclusive basis. The landlord should be careful to include those shared areas within the medical office suite that the tenant must use and those areas
that the tenant will likely use. In our example, the tenant will need access to the hallways, waiting area, reception area, and restroom. To the extent that a lab draw station exists within the medical office suite and the physician may perform phlebotomy services from time-to-time, then the lab draw station should be included as well. Counsel for the landlord should then identify those areas in the lease and on the floor plan as being leased on a “non-exclusive” basis as common areas.

Once the premises have been outlined, counsel for the landlord will also need to determine how the tenant will be charged for its share of the cost of the in-suite common areas (hallways, waiting area, reception area, and restroom in our example) for the medical office suite. CMS permits a landlord to charge a tenant for its share of common area costs, although the parties should be more concerned with establishing a fair market rate for the overall arrangement.13 For example, counsel for the landlord is often placed in a position where it is required to arrive at a rental rate using a formula that accounts for space that is leased on an exclusive basis, together with an add on factor for in-suite common areas. Interpreting floor area calculations and applying those numbers to a formula can be burdensome. As an alternative to this approach, counsel for the landlord may want to work with an appraiser or commercial real estate broker to establish a block rate for timeshare space in the building where the space is leased as a package arrangement. The rate would assume that the tenant will exclusively use three to four exam rooms, along with access to certain in-suite common areas and building services that cannot be modified by the tenant. This approach eliminates potential errors by the landlord in calculating the floor area for a particular arrangement. It also eliminates scenarios where tenants attempt to reduce the floor area to a limited amount of space in an effort to reduce the rental rate. A discussion on establishing fair market rental rates is set forth below.

Scheduling Challenges
Establishing an occupancy schedule and designating a set amount of time for the “block” or “use” periods present an additional operational challenge in administering a compliant timeshare leasing arrangement. Tenants often request short “use” periods, i.e. one- or two-hour time blocks, with the ability to cancel or reschedule the time blocks with little to no notice to the landlord. These types of scheduling requests could lead to a noncompliant timeshare leasing arrangement for several reasons.

For example, landlords may find it difficult to justify leasing arrangements with short use periods or varying blocks of time as commercially reasonable. This is primarily because these arrangements make it difficult for the landlord to lease the space to another tenant or to recoup its costs of operating the space. Landlords will find it even more difficult to justify as commercially reasonable if they allow constant scheduling changes as they may end up “holding” the space for a particular tenant on a full-time basis though only charging for the space on a part-time basis.

Another practical challenge in administering a compliant timeshare leasing arrangement stems from identifying the additional services the landlord provides.

Further, repeated schedule changes over a period of time may result in an “on-demand” lease. In Phase IV commentary of the Stark Law, CMS specifically stated that it viewed “on demand” rental agreements as problematic noting the CMS belief that these constitute a prohibited or suspect per-use or per-click arrangement.14 A landlord may also encounter administrative difficulties in monitoring a continuously changing occupancy schedule. This could lead to a violation of the requirement that the tenant exclusively use the leased space if multiple physician tenants mistakenly use overlapping space during the same period.

To address these concerns, legal counsel for landlords should clearly set forth an occupancy schedule in the written agreement for extended time periods. In the Stark Law commentary, CMS appears to suggest that block periods of not less than four hours are preferred to avoid the appearance of an “on-demand” leasing arrangement.15 Counsel should also include a notice provision that addresses whether the tenant has the ability to cancel or reschedule time blocks. Any language in a notice provision should be designed to prohibit a tenant from rescheduling unless the tenant has provided the landlord with at least thirty days advance notice. The notice is designed to avoid an “on-demand” leasing arrangement. If the landlord allows the tenant to reschedule a time block with thirty days written notice, the landlord could also create a template letter that documents the schedule change to avoid a miscommunication with the various parties. The landlord should consider limiting the number of schedule changes throughout the lease term.

Additional Space and Services
Another practical challenge in administering a compliant timeshare leasing arrangement stems from identifying the additional services the landlord provides. For example, the physician tenant in our example may only provide services in the leased premises for two days per week and find it administratively burdensome to travel to and from other office locations with medical records, staff, supplies, and/or equipment. The physician tenant may request that the landlord provide
administrative or clinical staff or storage space. In one recent Settlement Agreement under the SRDP, the hospital landlord permitted a physician tenant to use a storage closet free of rent for almost thirty years and absent any written agreement. Additionally, the OIG website identifies several other noncompliant leasing arrangements where staff and supplies were provided free of charge to the tenant and not included in the written lease agreement. This type of additional “service” may evolve over time as the tenant gradually accumulates medical records or patient volumes increase, resulting in a corresponding need for more supplies.

To ensure that the additional services are identified at the outset of the lease, the landlord should create a standard checklist of the services offered to tenants. When drafting the lease agreement, counsel for the landlord should ask that the landlord’s property manager confirm the services being offered to the tenant. The purpose is to identify in the lease which services are being provided and to ensure that such services are encapsulated in the rental rate. At a minimum, most checklists should include administrative and/or clinical staff, supplies, and storage space but could also include telephones, computers, medical waste removal, shredding, and/or internet access.

Further, to make certain the timeshare leasing arrangement remains compliant throughout its duration, the landlord should continuously monitor the space and services provided to the tenant. A landlord employee should audit the various timeshare locations on a frequent basis and track the use of the space through a floor plan and spreadsheet. A landlord may want to engage a third party property management company with responsibility for this oversight to alleviate the administrative burden on the hospital. With increasing budget pressures, most hospital landlords will likely designate one of its existing administrators as having responsibility for this oversight. This person should regularly meet with the compliance officer or legal counsel of the organization to ensure this monitoring occurs. If changes do occur during the term of the lease, the landlord should ensure the additional services are documented in a written amendment to the lease.

Setting the Rental Rate

Establishing fair market rental rates for timeshare arrangements is particularly important under the Stark Law and Anti-Kickback Statute. Counsel for the landlord should assume that the landlord’s staff members do not have the requisite experience and are not sufficiently objective to establish fair market rental rates. Therefore, counsel should strongly recommend that the landlord engage an experienced real estate appraiser or commercial real estate broker to provide a written opinion of value. While appraisals or opinions of value are not required under the Stark Law or the Anti-Kickback Statute, an independent valuation will provide evidence that the provider took substantial steps to establish fair market rental rates.

Establishing an occupancy schedule and designating a set amount of time for the “block” or “use” periods present an additional operational challenge in administering a compliant timeshare leasing arrangement.

If the landlord agrees to hire an appraiser or commercial real estate professional to establish fair market rates for the space, landlord’s counsel should engage the appraiser or real estate professional. This approach allows landlord’s counsel to protect the communications and reports from the valuator under the attorney-client privilege and work product doctrine. It also allows counsel to oversee the work of the valuator to ensure that the opinion issued takes into the account the correct assumptions for the leasing arrangements.

The authors of this article recommend that counsel engage valuators through an engagement letter that outlines the scope of work to be performed. The engagement letter should include the following:

❯ The location and type of property to be valued;
❯ Type of rental rate methodology to be used (usually a full-service or gross rental rate for timeshare arrangements);
❯ Type of building services offered to the tenant (e.g., utilities, general waste and medical waste disposal, receptionist services, medical supplies, etc.);
❯ Type and quality of furnishings that will be located within the leased premises (e.g., if the space is fully furnished as turn-key medical office space, it will likely command a higher value);
❯ The length of the proposed lease term (usually a term of one year for timeshare arrangements);
❯ Definitions of fair market value under the Stark Law and the Anti-Kickback Statute should be used for valuation purposes;
❯ A statement that the rental amount cannot be adjusted to reflect the additional value that the prospective landlord and tenant would attribute to the proximity or convenience to the other where one party is a potential source of patient referrals to the tenant;
corporate transactional matters, Medicare and Medicaid reimbursement, and legal and ethical issues involved in patient care and clinical research activities. Ms. Beachler regularly advises on the federal Stark Law, fraud and abuse laws, and other corporate counsel matters, including preparation and review of hospital, physician, and other provider contracts. She is a member of the American Health Lawyers Association and Illinois Association of Healthcare Attorneys. Ms. Beachler earned her law degree from Southern Methodist University Dedman School of Law in 2009 and an LL.M in Health Law with a Certificate in Health Care Ethics from St. Louis University School of Law in 2010. She is admitted to the bar in Illinois and Texas.

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Endnotes
3 42 U.S.C. § 1320a-7b.
5 Id.
7 42 C.F.R. § 1001.952(b).
8 Id.
10 11 Id.
12 Supra note 4.
13 Id.; see also 63 Fed. Reg. 1667 (Jan. 9, 1998).
15 Id.
16 Supra note 1.
17 Id.

Conclusion
Timeshare leasing arrangements are a familiar concept in the healthcare industry. Due to the technical requirements imposed by CMS, landlords face challenges in operationalizing these arrangements in compliance with the Stark Law and the Anti-Kickback Statute. It is likely that these operational challenges will result in a significant number of self-disclosures under the Stark SRDP program. Since most of the disclosures filed under the SRDP have not been settled to date, there is a level of uncertainty with how the government may treat noncompliant timeshare leasing arrangements. In light of this uncertain regulatory climate, landlords are well advised to develop a space lease compliance program and a series of best practices for timeshare leasing arrangements. Those best practices should include the use of property managers with healthcare compliance training, obtaining appraisals on fair market value rental rates and architectural measurements, and continuously monitoring the agreements to account for any changes in services or space.

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