

## THREE WAYS THE CMS PROPOSED STARK LAW CHANGES AFFECT SPACE LEASES

On October 9, 2019, the Centers for Medicare & Medicaid Services (“CMS”) issued a proposed rule (the “Proposed Rule”) to amend the regulations interpreting the Stark Law. The Proposed Rule revises material portions of the Stark Regulations and includes critically necessary guidance on leasing arrangements subject to the Stark Law. This article provides a summary of those parts of the Proposed Rule and guidance implicating leasing arrangements. For a broader overview of the proposed changes to Stark, please see Hall Render’s prior [article](#) on the subject, as well as the [text](#) of the Proposed Rule.

### CHANGES TO DEFINITIONS

CMS proposed several changes to the definitions applicable to existing exceptions, including changes to the definitions of (1) fair market value and (2) commercial reasonableness.

#### Fair Market Value

CMS proposed the following changes to the definition of fair market value:

- *Structure of Definition* – In lieu of the lengthy definition and piecemeal guidance on fair market value found in existing rulemaking, in the Proposed Rule, CMS advanced a general definition of fair market value as well as more specific definitions applicable to the rental of office space and rental of equipment. CMS also proposed structural changes to the definition of “general market value” to contemplate a modernized general definition, along with components specific to the rental of office space and equipment.
- *Principles of Market Value* – The Proposed Rule modifies the definition of “general market value” to more closely align with valuation principles of market value.
- *Volume or Value Standard* – CMS proposed removing references to the volume or value of referrals in the fair market value definition, as CMS believes the fair market value requirement is separate and distinct from the volume or value standard.
- *Intended Use in Rental Arrangements* – CMS also proposed removing from the fair market value definition the statement that “a rental payment does not take into account intended use if it takes into account costs incurred by the lessor in developing or upgrading the property or maintaining the property or its improvements.” CMS originally added this language to the Stark Regulations to clarify that rental payments may reflect the value of improvements or amenities provided by a landlord. However, CMS stated this language was unnecessary and has caused confusion over the years in its application.

#### Commercial Reasonableness

Several Stark exceptions, including those for the rental of office space and equipment, require the arrangement at issue to be “commercially reasonable” even if no referrals were made between the parties. Yet, the existing Stark Regulations neglect to define commercial reasonableness. Therefore, CMS proposed the following definition:

*Commercially reasonable* means that the particular arrangement furthers a legitimate business purpose of the parties and is on similar terms and conditions as like arrangements. An arrangement may be commercially reasonable even if it does not result in profit for one or more of the parties.

With this definition, CMS seeks to clarify its position that compensation arrangements subject to the Stark Law may be commercially reasonable even if they do not result in profit for one or more of the parties. In other words, the application of Stark Law does not turn entirely on profitability. CMS remarked that this language would resolve widespread misconceptions about the nexus between commercial reasonableness and profitability.

### CHANGES TO EXCLUSIVE USE REQUIREMENTS

In another significant proposal affecting office leases, the Proposed Rule includes a change to the exclusive use requirement in the Rental of Office Space Exception that allows a tenant (and any other tenants operating in the same office space) to use the same office space so long

as the landlord is excluded from the space.[1] Originally intended to prevent sham leases where the landlord rents office space to a tenant but continues to use the space, CMS found that in practice the simultaneous use of office space by multiple tenants does not create risk of patient or program abuse, so long as the other requirements set forth in the Rental of Office Space Exception are satisfied. Through the CMS self-disclosure protocol for potential Stark Law violations (“SRDP”), CMS reviewed several leasing arrangements where multiple tenants used the same office space contemporaneously or in close succession to one another. For example, in one case, two tenants used the same office space to provide care to a single patient, which, rather than resulting in abuse to the system, actually enhanced patient care and convenience.

## **EXPANDING WHICH EXCEPTIONS MAY APPLY TO SPACE LEASES**

Under current guidance, space lease arrangements are required to fit within the Rental of Office Space Exception. CMS stated in the Proposed Rule, however, that other exceptions may apply depending on the circumstances of the lease.

### **Fair Market Value Exception**

Prior to the release of the Proposed Rule, CMS reviewed several SRDP submissions regarding legitimate, non-abusive space leasing arrangements that could not satisfy either (a) the Rental of Office Space Exception (because the term was less than one year) or (b) the Timeshare Exception (because the arrangement conveyed a possessory leasehold interest). In light of those submissions, CMS has proposed extending the Fair Market Value Exception to apply to leasing arrangements, but with an express prohibition on percentage-based rent and per-unit based service compensation (i.e., per-click formulas).

CMS’s comments on this issue were particularly focused on relying on the Fair Market Value Exception for leasing arrangements with a term of less than one year. However, CMS also referred to utilizing the Fair Market Value Exception for subleases and timeshare arrangements, although CMS did not provide a full analysis of how these arrangements might fit within the exception.

### **Certain Arrangements with Hospitals Exception**

According to CMS, rental payments may be covered by the Certain Arrangements with Hospitals Exception, which protects remuneration provided by a hospital to a physician if the remuneration is unrelated to designated health services (“DHS”).[2] CMS maintained this exception could cover, for example, rental payments made by a teaching hospital to a physician to rent his or her house as a residence for a visiting faculty member. But CMS stopped short of allowing other types of rental arrangements to be covered by this exception. CMS proposed that the rental of office space (where patient care services are provided) is remuneration related to the provision of DHS and therefore would not be covered by this exception.

### **Payments by a Physician Exception**

In the Proposed Rule, CMS recognized the Payments by a Physician Exception[3] historically has not been available for office leases because CMS viewed the exception as covering only items and services, not leases. However, in the Proposed Rule, CMS points out it originally designed this exception as a “catch-all” for legitimate arrangements not covered by another exception (such as office leases, which could be structured to fit within the rental of office space exception). CMS proposed, therefore, allowing the Payments by a Physician Exception to protect payments by a physician for the lease or use of space other than office space, such as for leases of storage space or residential real estate. CMS made clear, however, it is not proposing that this exception be available to protect office leases, including short-term leases.

\* \* \*

If you are interested in submitting a comment to CMS on the Proposed Rule or would like additional information about the Proposed Rule, please contact:

- **Andrew Dick** at (317) 977-1491 or [adick@hallrender.com](mailto:adick@hallrender.com);
- **Addison Bradford** at (317) 977-1403 or [abradford@hallrender.com](mailto:abradford@hallrender.com);
- **Joel Swider** at (317) 429-3638 or [jswider@hallrender.com](mailto:jswider@hallrender.com); or
- Your regular Hall Render attorney.

For more information on Hall Render’s Real Estate services, click [here](#).

[references]

[1] See 42 CFR § 411.357(a). It should be noted that CMS also proposed an analogous change to the rental of equipment exception set forth in 42 CFR § 411.357(b).

[2] 42 CFR § 411.357(g).

[3] 42 CFR § 411.357(i).

[/references]