

CMS FINALIZES RULE AFFECTING HOLDOVERS IN SPACE LEASING ARRANGEMENTS UNDER THE STARK LAW

OVERVIEW

On October 30, 2015, the Centers for Medicare & Medicaid Services ("CMS") announced the final rule ("Final Rule")¹ in follow up to the proposed rule published in July 2015 pertaining to payment policies under the Physician Fee Schedule for CY 2016 ("Proposed Rule"). In addition to changes to the Physician Fee Schedule and other updates regarding payment policies, payment rates and quality provisions for services covered by the Physician Fee Schedule, the Final Rule also provided for updates and modifications to the Physician Self-Referral (Stark) regulations by creating two new exceptions to the referral prohibition (a summary of the new timeshare license exception can be found [here](#)) and several other clarifications.

This article is limited to a discussion of the Final Rule as it relates to holdovers in space lease arrangements. A summary of all of issues impacted by the Final Rule can be found [here](#).

HOLDOVER ARRANGEMENTS IN SPACE LEASES

In the Proposed Rule, CMS discussed its rationale for establishing a term of one year for various arrangements, including leasing arrangements. CMS noted that the requirement was designed to establish stable arrangements between providers that cannot be renegotiated frequently to reflect the current volume or value of referrals. Along the same lines, CMS has historically concluded that holdover arrangements could pose an increased risk of abuse among providers. As such, CMS historically limited holdover arrangements to a period of six months and only so long as the holdover continued on the same terms and conditions as the original arrangement. CMS determined that there was little risk of abuse if the holdover period was limited in duration and the arrangement continued on the same terms and conditions.

Through its administration of the Stark Physician Self-Referral Disclosure Protocol ("SRDP"), CMS reviewed numerous rental arrangements that failed to satisfy the requirements of an applicable exception solely because the arrangement expired by its terms, and the parties continued the arrangement on the same (compliant) terms and conditions after the six-month holdover period ended. Through **that experience**, CMS found that an arrangement that continues beyond the six-month period does not pose a risk of program or patient abuse, provided the arrangement continues to satisfy the specific requirements of the Rental of Office Space exception. CMS reconsidered their previous position and proposed to eliminate the time limitations on holdovers, provided there would be safeguards to address two potential sources of program or patient abuse: frequent renegotiation of **short-term** arrangements that take into account a physician's referrals and compensation or rental changes that become inconsistent with fair market value over time.

In the Proposed Rule, CMS suggested amending the holdover provision in the Rental of Office Space exception (and other compensation exceptions) to permit indefinite holdovers, provided that certain safeguards are met. In the alternative, CMS proposed to allow holdover arrangements for definite periods of time longer than six months (e.g., a one-,two- or three-year holdover period) or for a period of time equivalent to the term of the immediately preceding arrangement.

In the Final Rule, CMS adopted the proposed indefinite holdover provisions for the Rental of Office Space exception, with safeguards that are already in the regulations. Specifically, the Final Rule provides that if the lease arrangement expires after a term of at least one year, an indefinite holdover lease arrangement immediately following the expiration of the lease arrangement satisfies the requirements of the Rental of Office Space exception if the following conditions are met:

- (i) The original lease arrangement met the conditions of Rental of Office Space exception when the arrangement expired;
- (ii) The holdover lease arrangement is on the same terms and conditions as the immediately preceding arrangement; and
- (iii) The holdover lease arrangement continues to satisfy the conditions of the Rental of Office Space exception.

Caveats:

CMS supplemented the Final Rule with responses to commentary and questions on a number practical matters.

- Regarding the type of evidence that may be necessary to establish that a holdover arrangement continued on the same terms and conditions as the immediately preceding arrangement, CMS noted that documentary evidence may be required, including evidence of the expired lease and a collection of other documents, including contemporaneous documents evidencing the course of conduct between the parties.
- Regarding lease arrangements that do not contain explicit holdover provisions, CMS has taken the position that an expired written contract, on its own, cannot satisfy the writing requirement of an applicable exception. Without additional supporting documentation, there may be gaps in compliance, as it may take some time after the expiration of the written contract to generate sufficient documents evidencing the course of conduct between the parties after the contract expired. In contrast, in the case of a contract that contains a holdover provision, the parties can rely in part on the expired written contract to satisfy the writing requirement for the holdover period. They noted, however, that parties relying on the holdover provisions must still have contemporaneous documents establishing that the holdover continued on the same terms and conditions as the immediately preceding arrangement. That is, a party must be able to establish that it satisfied the requirements for the holdover period.
- Rental amounts falling below fair market value during a holdover will result in a non-compliant lease arrangement. According to CMS, ongoing compliance with the fair market value requirement during the holdover is necessary to prevent program or patient abuse. As soon as a holdover arrangement ceases to meet all the requirements of an applicable exception, including the fair market value requirement, referrals for designated health services by the physician to the entity that is a party to the arrangement are no longer permissible.
- Under the revised regulations, an indefinite holdover lease arrangement is permitted if the arrangement continues on the same terms and conditions as the immediately preceding arrangement. The holdover arrangement must continue on the same terms and conditions because frequent renegotiation of short-term arrangements poses a risk of program or patient abuse. CMS is concerned with the renegotiation of terms during the holdover because the parties may be influenced to negotiated terms based on the volume or value of referrals. Thus, parties are not permitted to amend the terms and conditions of an arrangement during a holdover, because such changes pose a risk of program or patient abuse.
- Regarding whether lessors can charge a holdover premium, CMS reiterated its position that a holdover premium is allowed "provided that the amount of the premium was set in advance in the lease agreement (or in any subsequent renewal) at the time of its execution and the rental rate (including the premium) remains consistent with fair market value and does not take into account the volume or value of referrals or other business generated between the parties." CMS stated the same principles apply to the indefinite holdover provisions in the Final Rule. The rental amount with the holdover premium must satisfy the fair market value requirement when the original agreement expires and throughout the holdover. In addition, the failure to charge a holdover premium may result in an impermissible change in terms or constitute the forgiveness of a debt, thus creating a secondary financial relationship between the parties that must satisfy the requirement of an applicable exception.
- The indefinite holdover provisions will be effective on January 1, 2016. Parties who are in a valid holdover arrangement under the prior six-month holdover provisions on January 1 may make use of the new indefinite holdover provisions, provided that all the requirements of the new holdover provisions are met. On the other hand, if a pre-existing holdover has lasted for more than six months as of January 1, then the parties cannot make use of the new indefinite holdover provisions.

If you have questions or would like additional information about the impact of the Final Rule on your space leasing arrangements, please contact:

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¹For a full text copy of the Final Rule, click [here](#).