PG Briefing
November 13, 2020

Shared Space Arrangements in Health Care – Small Dollars, Big Risk

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Key Takeaways

- Shared Space Arrangements (SSAs) can be a powerful strategy to achieve the organization's mission and business objectives.
- Despite small dollars, SSAs can create significant compliance risk.
- Adhering to a standardized compliance checklist can help ensure the risk is better managed.
- In addition to accounting for dedicated space, an appropriate allocation of shared space must be considered under the arrangement.
- The entire scope of operations should be thoughtfully contemplated, and the value of benefits one party provides to another should be accounted for in the FMV payment.
- Working with a third-party appraisal company can enhance the documentation and consistency to support legal, compliance, finance and operations.

As health care organizations continue to grow, expanding key access points in markets where the organization does not have a physical presence could be a critical strategic consideration moving forward. To address this, some health care entities will develop shared space arrangements (SSAs). SSAs in health care involve one party who makes payments to another party for the right to utilize owned or leased medical office space (e.g., a hospital utilizing medical office space owned or leased by a medical group).

SSAs can be an efficient way to provide better access to care within communities and create alignment with a broader cohort of providers, and many health care entities can establish and operate relatively simple and cost-effective SSAs.

Through SSAs, health care organizations can send physicians (typically surgical or sub- specialty physicians) and other clinical personnel to underrepresented areas without significant capital investment. In many cases, such as in underserved rural communities or smaller population outreach areas, SSAs allow access to specialty care that would otherwise be unavailable in the local market. Many health care entities find that these arrangements provide an effective strategy to further both the organization's mission and business objectives.

Although these arrangements may be small in dollars, SSAs may carry significant compliance risks.

Across the health care industry, the impact of inappropriate relationships has led to increased regulatory scrutiny. Due to the potential referral relationship that may exist between the parties of a shared space transaction, these arrangements are susceptible to government review, compliance violations, and disciplinary action if not structured appropriately.

This article focuses on the importance of ensuring that payments made under SSAs are fair market value (FMV) and presents specific and actionable recommendations that health care entities can follow to minimize compliance risk with their SSAs.

Shared Space Arrangements – Risk to the Organization

Recent settlements with the Department of Justice (DOJ) highlight compliance risks that can result in significant government penalties for organizations that allegedly do not structure SSAs appropriately.

In 2018, a health system agreed to pay DOJ over $80 million to settle claims arising from allegedly improper payments to referring physicians.[1] The DOJ alleged that the system made payments in surplus of FMV and provided free or below-FMV rent in medical office space to specific physicians, which the DOJ construed as attempting to secure patient referrals in violation of the Anti-Kickback Statute and Stark Law. Since claims were submitted to government payers for services provided to these referred patients, violations of the False Claims Act were also alleged.[2]

A second case from the West Coast involved a large acute care hospital that agreed to pay over $40 million to settle allegations of improper financial relationships with referring physicians. The alleged improper physician payments were in the form of the hospital paying rent that purportedly exceeded FMV for medical office space and marketing arrangements that were made to allegedly provide disproportionate benefits to physicians with whom the hospital had referral relationships.[3] Similar to the first example, in addition to the Anti-Kickback Statute and the Stark Law, the DOJ alleged that the False Claims Act was violated since claims were submitted to government payers for services provided to referred patients.

Discussion and Recommendations for Compliant Shared Space Arrangements

While SSAs may pose a significant compliance risk, steps can be taken to compliantly structure and ensure payments are supported as FMV under these agreements. In general, parties to a shared space transaction should have a clear and contractually defined understanding of the amount of dedicated and shared space for which each party is responsible. They should consider the entire scope of operations and allocations that exist under the arrangement including services, technology, and resources that each party provides the other.

We have developed a checklist of questions for health care organizations to standardize and apply when evaluating the compliance profile of their SSA structures. The questions have been developed from the perspective of a host practice subleasing to a health care organization but could easily represent a reversed relationship (i.e., a health care organization subleasing to a physician practice).

These questions have been designed to help organizations identify and address the requirements for compliant SSAs and to complete the appropriate documentation.

- What class of building is the medical office building? (e.g., Class A, B, C, etc.?)
- What type of lease is held by the host practice (lessor) for purposes of comparison? (e.g., Triple Net, Modified Net, Gross, or Modified Gross?)
- What are appropriate, market-supported payment rates for the square footage leased, considering the specific building and type of lease?
- How often will the lessee be in the space? (e.g., once per week for four hours per day, three times per week for eight hours per day, etc.)
- How much square footage of dedicated space is leased by the lessee?
- How much square footage of shared space is allocated to the lessee?
- Will the lessee utilize supplies or equipment (medical or non-medical) purchased by the lessor without a separate contractual payment?
- Will the lessee benefit from IT capabilities such as computer hardware, internet/Wi-Fi without a separate contractual payment?
- Will the lessee utilize personnel employed by the lessor, such as technicians or front-office staff, without a separate contractual payment?
- Will the lessee benefit from any other resources where the lessor bears the burden of the cost, without a separate contractual payment?
- Are there any joint or co-branded marketing efforts that need to be considered?

This checklist may be used as a tool for health care organizations' internal stakeholders (e.g., operators, counsel, physicians, etc.) to jointly contemplate in the evaluation of current and future SSAs. The consensus among stakeholders regarding the structure of an SSA, which the checklist assists in formulating, can minimize compliance risk and improve the efficacy of the arrangement itself.

The key considerations related to these checklist questions are further discussed in the three sub-sections below.

FMV Payment for Leased Space – Key Considerations

When determining a FMV payment rate for leased space under an SSA, ensuring that the selected payment is supported by the market for the type of building and lease is essential. Examples of lease payments made for similar medical office buildings in the local market should be compiled and analyzed to determine an appropriate payment range per square foot to apply to the subject arrangement.

These market comparable data points may need to be further adjusted, depending on the arrangement. For example, if the lease rate supported by the market comparable examples reflects modified gross leases, applying an upwards adjustment to the rates for a gross lease under the subject arrangement may be appropriate because a gross lease would include payment for real estate taxes, casualty insurance, utilities (electric, water, and gas), and routine maintenance of the grounds, all of which would not typically be included in the payments made for a modified gross lease.

Furthermore, it may also be appropriate to apply an additional adjustment to the payment rates indicated by the market comparable examples for the building. A premium typically exists for medical space, and newer medical office buildings often have amenities not available in older medical buildings. Industry benchmark information is available to categorize and apply appropriate adjustments. Additional premiums on the space that could be considered include a "smaller size" of the rental area compared with typical lease arrangement and a shorter lease term.

Once an appropriate rate per square foot has been selected, the rate may then be applied to the square footage leased by the lessee (inclusive of leased dedicated space and allocated shared space). For example, the parties may normalize the rate per square foot to a daily payment if the lessee only utilizes the space a couple of times per week, allowing for flexible scheduling while remaining compliant with FMV considerations.

Dedicated Space and Shared Space – Who's Responsible for What?

Parties to a shared space transaction often have a clear understanding of the dedicated space leased under the arrangement. Typically, a shared space contract will specify that a set number of exam rooms, offices, and other areas will be exclusively utilized by the lessee when the lessee is in the space. Matching a FMV payment rate to the dedicated space used by the lessee is typically a straightforward exercise.

However, in many SSAs, the lessee also benefits from large sections of shared space in the building. But since the lessor may also utilize the shared space, the lessee should not bear the full payment burden for the entire shared space. Instead, an appropriate allocation should be applied for the purposes of making FMV payments.

Shared space and appropriate allocation methodologies can vary on a case-by-case basis. For example, a more complicated shared space allocation might include a medical office building with on-site imaging (e.g., X-ray machine, computed tomography scanner, etc.) that the lessor and lessee can use while both parties are operating in the space. In this instance, allocating the appropriate amount of shared space proportionate to the lessee's utilization and associated cost is essential.

More straightforward examples of shared space might include patient waiting rooms, break rooms, and hallways. Since both the lessee and lessor may utilize and benefit from this shared space, an appropriate allocation of the space to the lessee should be determined. A reliable methodology of allocating these kinds of shared spaces is to compare the percentage of dedicated space that the

lessee utilizes to the entire available dedicated square footage in the building and then apply that percentage to the entire shared space square footage in the building.

Scope of Operations – Each Arrangement Is Different

In addition to selecting a FMV payment rate for leased space and determining the amount of dedicated and shared to allocate to the lessee, parties to a shared space transaction should map out what the entire operation looks like. As summarized in the checklist presented earlier in this article, many factors can affect the scope of an SSA. Understanding what is included, what is excluded, and what the expectations of each party are is critical. When those expectations are understood and agreed upon by both parties, the value of benefits one party provides to another should be accounted for in the determination of FMV payments in addition to the FMV payment for the space itself.

At its simplest, an SSA could be a payment solely for utilizing the space that includes dedicated space and a reasonable allocation for shared space. At its most complex, an SSA could be a payment that includes personnel, technology, and equipment. In this case, the parties must reconcile the full scope of leased operations to a value that can be supported for compliance purposes as FMV payment.

An Example Shared Space Arrangement: Checklist in Action

The following is a real-world example of assessing the FMV lease rate for an SSA. A hospital and an orthopedic medical group (Group) have a contractual arrangement whereby hospital-employed physicians schedule patient visits simultaneously with physicians employed by Group in space master-leased by the Group. The hospital utilizes the space to operate a spine, trauma, and pediatric clinic during the day and an after-hours orthopedic urgent care clinic for adults and pediatrics in the evening. By utilizing the checklist outlined earlier in this article as a guide, the arrangement is documented as follows:

- Type of Medical Office Building: Class A.
- Type of Lease: Gross Market Lease.
- Market Supported Lease Payment Rates: Range $25 to $40 per square foot (based on analysis of comparable lease rates in the local market).
- Time in Space: Eight hours per day, 182 days per year.
- Leased Dedicated Space: 500 square feet consisting of several exam rooms and an office.
- Allocated Shared Space: Total of 54 square feet allocated to lessee out of 3,800 total square feet of shared space.
- Supplies / Equipment Utilized: Hospital utilizes select medical supplies purchased by the Group.
- IT Capabilities Utilized: Hospital utilizes internet / Wi-Fi access provided by the Group.
- Personnel Utilized: Hospital utilizes a cast technician employed by the Group.

The outcome of the assumptions and financial modeling resulted in determining a daily payment that could be supported as FMV for the hospital to lease the Group's space. The FMV payment is determined by matching the market-supported lease payment rates to the total square footage attributed to the hospital under the SSA (i.e., 554 square feet) and normalizing to an appropriate daily rate.

Furthermore, the analysis included the burden of costs borne by the Group that are utilized by the hospital without a separate contractual payment. Using benchmark data for equipment utilized, internet / Wi-Fi access, and cast technician compensation, the analysis determined daily payment rates for each item (specific to the hospital's utilization) that could be supported as FMV.

To match the terms of the contract, the opinion of FMV is presented as a daily payment that included the value of the square footage, equipment utilized, internet / Wi-Fi, and cast technician utilization under the SSA. Completing the analysis outlined above will help ensure that the final contractual daily payment agreed upon by the hospital and Group can be supported as FMV.

This example illustrates the breadth of potential unique facts and circumstances that can occur within SSAs. Understanding these nuances is vital from both the compliance and business perspectives. The checklist and guidance contained herein can help organizations map out the structure of their SSAs, create consistency, and gather agreement among stakeholders before numbers are set, thus minimizing risk to the parties of a shared space transaction. Of course, for particularly complex SSAs, it may make sense to bring in a third party to assess FMV, particularly if a health care system does not yet have that expertise in house.

Comment on Commercial Reasonableness

Although not the focus of this article, another component to keep in mind is commercial reasonableness. Regarding commercial reasonableness, the federal government has stated that "the key question to ask when determining whether an arrangement is commercially reasonable is simply whether the arrangement makes sense as a means to accomplish the parties' goals."[4]

The government further stated:

> We are proposing two alternative definitions for the term "commercially reasonable." First, we are proposing to define "commercially reasonable" to mean that the particular arrangement furthers a legitimate business purpose of the parties and is on similar terms and conditions as like arrangements. In the alternative, we are proposing to define "commercially reasonable" to mean that the arrangement makes commercial sense and is entered into by a reasonable entity of similar type and size and a reasonable physician of similar scope and specialty. We are also proposing to clarify in regulation text that an arrangement may be commercially reasonable even if it does not result in profit for one or more of the parties.[5]

This guidance on the standard of commercial reasonableness indicates that overall business logic and solid rationale must exist as the core of arrangements between physicians and hospitals. As a result, this requirement's scope entails a review of the arrangement in aggregate, apart from the financial terms per se. Commercial reasonableness documentation can be performed internally or by an external resource. In the context of SSAs, the contracted/paid rate could be supported by FMV, but the space is not occupied or used. This would be an extreme example of an arrangement that meets the standards to be deemed FMV but likely not meet the commercially reasonableness standard because the space is not being utilized.

Conclusion

From providing previously inaccessible specialty care to rural markets to making a strategic entry into a market without significant capital investment, SSAs provide an opportunity for health care organizations to further both their mission and business objectives. However, SSAs are also a target of increased regulatory scrutiny, and despite the relatively small dollars typically associated with these contracts, carry significant compliance risk.

Organizations must ensure that all aspects of an SSA are carefully considered. Space and resources being utilized under an SSA should match the expectations defined in the contract and be reconciled to a value that can be supported for compliance purposes as FMV payment. The guidance provided in this article may be utilized as a framework to assist health care organizations in minimizing the compliance risk and maximizing the efficacy of their SSAs.

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[1] Department of Justice, *Detroit Area Hospital System to Pay $84.5 Million to Settle False Claims Act Allegations Arising from Improper Payments to Referring Physicians* (Aug. 2, 2018), https://www.justice.gov/opa/pr/detroit-area-hospital-system-pay-845-million-settle-false-claims-act- allegations-arising.

[2] *Id.*

[3] Department of Justice, *Los Angeles Hospital Agrees to Pay $42 Million*, (June 28, 2017), https://www.justice.gov/opa/pr/los-angeles-hospital-agrees-pay-42-million-settle-alleged-false-claims-act- violations-arising.

[4] Medicare Program; Modernizing and Clarifying the Physician Self-Referral Regulations, 84 Fed. Reg. 55766, 55790 (proposed Oct. 17, 2019).

[5] *Id.*