

PG Briefing

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Medical Timeshares Require More Than What You Learned in Kindergarten

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I. INTRODUCTION

Health care providers frequently find that they have leased too much space and can reduce their overhead expense if they can enter into a partial sublease of their office space (commonly referred to as a “medical timeshare”) with another health care provider. This type of arrangement can also defray additional overhead expense if it includes the time and services of the health care provider’s administrative and clinical staff as well as use of equipment.¹ For a single physician who is just starting her practice or looking for a part-time second location, a medical timeshare within another practice is very appealing and certainly preferable to entering into a speculative lease arrangement.

Similar to executive office timeshares, medical timeshares allow physician tenants to rent space on a part-time basis (typically in four-hour time slots). The medical office space is controlled by independent physician practices or hospitals and can be tailored to meet the needs of specialists or generalists. By leasing space based on total time used, the health care provider can assess a new market and expand its patient base without the high overhead and start-up costs of a full-time office.

A hospital or other health care business may even design a traditional medical office space as a timeshare space by utilizing medical suite space located within the adjacent medical office building. The timeshare suite will typically consist of several exam rooms, a waiting room, check-in desk, physician office, nurse station, etc. The hospital will purchase the furniture and equipment for each room and provide other services. Some timeshare suites will have a front desk receptionist or clinical nurse available.

More frequently, though, existing physician office space is available in a larger practice with underutilized space, and time and space can be offered to non-practice (external) physicians on a time-slot basis. This arrangement typically consists of exclusive access by the tenant of certain identified rooms (exam rooms, physician office, etc.), while sharing certain common areas with the landlord provider also using the space. The leasing medical practice will provide all the furniture and equipment for each room and typically make available many of the resources that already exist in the practice. It is also common for the tenant to share the medical practice’s front desk receptionist on a limited use basis.

When helping clients consider this type of opportunity, real estate and health care attorneys must understand the issues and pitfalls in negotiating and drafting medical timeshares, and they must be able to convey those issues and pitfalls to clients. They must also be able to negotiate medical timeshare documents that both operate successfully for the prime landlord, sublandlord, and subtenant and comply with state and federal laws governing referral relationships between health care entities. Both the Stark Law² and federal Anti-Kickback Statute (AKS)³ contain exceptions or safe harbors that govern proper ways to structure medical timeshares between health care providers.⁴ If at all possible, it is optimal to meet the timeshare exceptions or safe harbors to ensure there is no allegation of payment for referrals between the parties.

The parties can reap multiple benefits from a medical timeshare, but determining the appropriate timeshare lease rate for medical timeshares can be challenging and complex. Over the past several years, the Department of Health and Human Services Office of Inspector General (OIG) has become increasingly critical of the medical timeshare concept and has implemented stringent regulations that we will discuss below. For example, providing space or equipment to a referring physician generally creates a financial relationship that triggers Stark Law considerations. Consequently, such arrangements will need to satisfy a Stark Law exception, in addition to the AKS safe harbors for leases of space or equipment.

Failing to satisfy requirements of the Stark Law and the AKS comes with steep penalties. Stark Law noncompliance can include repayment of the rent, repayment of Medicare billings, and monetary penalties of up to \$24,254 per improper claim. AKS violations may be subject to a \$25,000 criminal fine, a possible five-year prison sentence, \$50,000 penalty, fines in excess of three times the damages incurred, and possible exclusion from Medicare and Medicaid. Moreover, Stark Law and AKS violations will trigger liability under the federal False Claims Act (FCA).⁵ With these types of penalties, it is easy to see why providers must carefully evaluate and document medical timeshares.

II. COMMON MISCONCEPTION AND TIMESHARE FORMATS

The most common misconception is that drafting a medical timeshare is "easy" or "simple"—e.g., a short, one-page document to which the prime lease is attached. This is not the case. Medical timeshare documentation is more involved and complex than the documentation for a standard lease because there are multiple parties, multiple documents, and complex issues. To make matters worse, the client or the broker, or both, often exert pressure to quickly create a simple and inexpensive document for the medical timeshare.

The structure itself makes simple and inexpensive difficult to achieve, if not impossible. In the case of medical timeshares, at least three parties are in the mix: prime landlord, original tenant/sublandlord, and subtenant. Further, the arrangement encompasses at least two documents among these three parties: prime lease and timeshare sublease. And when considering the structure of the arrangement, the medical timeshare instrument can take different forms.

First, the parties can use the prime lease as a template. In other words, the entire prime lease is repeated in a timeshare form. This can result in an unnecessarily long timeshare document.

Second, the parties could consider entering an entirely new lease, so long as special care is taken that none of the provisions go outside of the boundaries of the prime lease. Again, this can result in an unnecessarily long timeshare document.

Thus, the parties often rely on the third, and most typical, format for medical timeshares—incorporating the entire prime lease by reference into the timeshare sublease document. This often involves including a statement that all references in the prime lease to "Landlord" will refer to the sublandlord, all references to "Tenant" will refer to the

subtenant, all references to "Premises" shall refer to the timeshare premises, etc. Using this structure also requires careful consideration of what rights and obligations under the prime lease need to be excluded or revised for the timeshare parties. This means that the subleasing provider will need to review the prime lease *in its entirety* to determine whether other provisions exist that would be inappropriate to incorporate into the medical timeshare document.

Before we get into further details about options for a medical timeshare, we remind parties to seek experienced counsel to navigate the facts and circumstances of the specific arrangement. While we discuss a variety of concerns, it is not possible to address all concerns or nuances that could arise in any given arrangement. Accordingly, we divide our discussion into three major topics: (1) General Issues; (2) Select Items and Terms; (3) Prime Landlord Concerns; (4) Lender Concerns; (5) Fair Market Value and Other Legal Considerations; and (6) Legal Pitfalls for Stark and AKS.

III. GENERAL ISSUES

In general, the prime lease sets the limits of any timeshare arrangement, and the timeshare will always be subject to and subordinate to the prime lease. If the prime lease terminates for any reason, the timeshare will likewise terminate. It is critical to the subtenant that the sublandlord timely perform under the prime lease and, if not, that the subtenant obtains rights and time to perform the sublandlord's obligations on behalf of the sublandlord.

Most leases will contain provisions regarding conditions to subleasing or limitations on the existing tenant's right to timeshare the prime leased premises. The parties should carefully review these provisions as they could affect the business terms between sublandlord and subtenant. Additionally, special attention should be paid to any use restrictions found in the prime lease, which may preclude the subtenant's desired, intended use. For example, the prime lease may require the leased premises be used only for non-medical, commercial purposes, thereby precluding the premise's use as a medical office building. In most cases, the prime landlord's consent will be required for the tenant to timeshare all or a portion of the prime leased premises.

Also in a timeshare structure, no privity of contract exists between the prime landlord and the subtenant. The subtenant has rights only vis-à-vis the sublandlord. Therefore, the subtenant's only right if the prime landlord fails to perform its obligations under the prime lease is to require that the sublandlord enforce its rights against the prime landlord under the prime lease. Each party can only be responsible for what it is practically able to do. Accordingly, the subtenant will want to ensure appropriate language in the timeshare agreement to put certain landlord obligations on the sublandlord.

If the prime lease is incorporated by reference, any subsequent modifications to the prime lease will apply to the timeshare. Thus, the subtenant will want to retain control over sublandlord's ability to amend the terms of the timeshare; however, if the timeshare covers only a portion of the prime leased premises or a portion of the term of the prime lease, the sublandlord will want to retain the right to modify the prime lease without consent of the subtenant. As a compromise, the parties can agree that the sublandlord will not modify the terms of the prime lease without the subtenant's consent, to the extent such amendment would: (a) adversely affect the subtenant's rights under the timeshare; (b) increase the obligations of subtenant under the timeshare; or (c) decrease the size of the timeshared premises, shorten the term of the timeshare, or otherwise materially affect the timeshared premises. And the sublandlord should be able to amend the provisions of the prime lease that by definition are excluded from the timeshare arrangement.

For obligations that the sublandlord cannot perform due to the nature of the obligations, the sublandlord should not assume liability for non-performance unless the non-performance is caused by a default by the sublandlord. Below are some solutions that the subtenant can negotiate in order to mitigate risks resulting from the fact that the subtenant does not have privity of contract with, or enforcement rights against, the prime landlord.

First, the timeshare should require that the sublandlord take all reasonable action to enforce its rights against the prime landlord under the prime lease for non-performance by the prime landlord. Taking such action will usually be at the sole cost and expense of the subtenant. If enforcing the obligations of the prime landlord would benefit portions of the prime leased premises not part of the timeshared premises, then the costs of enforcement should be allocated accordingly between the subtenant and sublandlord.

Second, the timeshare may provide that the sublandlord partially assigns its enforcement rights to the subtenant in the event that the prime landlord continues to fail to perform its obligations under the prime lease, which assignment should include the right to proceed against the prime landlord in the subtenant's own name. The partial assignment also should expressly state that all rights of sublandlord under the prime lease are conferred upon and transferred to subtenant. Subtenant shall be subrogated to any rights of the sublandlord as such rights apply to the timeshared premises. In certain instances under the prime lease, the sublandlord may not be permitted to assign or partially assign such rights to the subtenant, so the subtenant may require that sublandlord permit subtenant to proceed against prime landlord in sublandlord's name.

Third, to the extent that the prime lease permits the tenant under the prime lease to exercise self-help remedies, sublandlord should agree to exercise such rights for the benefit of the subtenant. Note that the sublandlord may not be able to exercise these rights or may not want to provide this right to the subtenant if the timeshared premises is only a portion of the prime leased premises.

Fourth, the parties should negotiate whether sublandlord's right to abatement, credits, set-off, or offset under the prime lease should pass through to the subtenant, to the extent related to the timeshared premises. Be wary of one potential issue with simply passing through to the timeshare abatement and similar rights under the prime lease; circumstances may arise where subtenant's right to abatement is triggered, but sublandlord's right to abatement is not. This can result if the trigger for such right is tied to a threshold. Thus, an incorporation into the timeshare without any limitation may provide the subtenant with an abatement right against the sublandlord that is not available to the sublandlord under the prime lease.

Finally, if the subtenant cannot obtain the right to proceed against the prime landlord because the prime lease does not permit assignment of enforcement rights to the subtenant, subtenant should request a recognition agreement from the prime landlord. A recognition agreement provides subtenant with privity of contract with the prime landlord, but many prime landlords are unwilling to enter into recognition agreements because it expands the scope of liability of the prime landlord and may increase prime landlord's obligations.

As one might guess, a host of other general considerations may present themselves, such as:

- *Entire Premises v. Partial Premises.* When the subtenant timeshares the entire prime leased premises, obligations are more cleanly passed through to the subtenant because there is no remainder premises for which the sublandlord remains responsible. When the timeshared premises is less than the entire prime leased premises, more careful consideration should be made as to what obligations and rights pass through to the subtenant. The same attention should be paid to maintenance and repair obligations between the sublandlord and subtenant that would not be necessary under the prime lease between the prime landlord and tenant.
- *Use of Equipment.* Typically, a medical timeshare includes a fee for use of general fixtures and equipment in the space. It can also include more sophisticated medical diagnostic equipment such as imaging or laser equipment.
- *Use of Staff.* Frequently medical timeshares include use of receptionists, medical assistants, or nursing staff to assist the health care provider during the time period in which the provider is using the space. Care

must be taken to calculate the full cost of the salaries and benefits when apportioning their time to the timeshare.

- *Length of Term.* If the parties intend that the timeshare cover the entire remainder of the term of the prime lease, the parties may want to stipulate the term of the timeshare to be one day shorter than the remainder of the term of the prime lease to mitigate the risk that the timeshare be deemed by a court to be an assignment of the prime lease. Special attention must be paid to the remainder of the term of the prime lease in the health care context, namely vis-a-vis the requirement of at least a one-year term for applicable Stark Law exceptions and AKS safe harbors.
- *Computation of Time.* It is critical that the time in the timeshare be recomputed and that the parties do not simply just rely on times referenced in the prime lease. If an event requires action of the prime landlord or action by the sublandlord to the prime landlord, then the time periods under the timeshare need to be shorter or longer to accommodate the additional step of working through the sublandlord. Addressing the issues with time limits can be handled by specifically stating different time limits for specific circumstances and then including a "catch-all" provision covering the duration of time limits not specifically addressed in the timeshare.

IV. SELECT ITEMS AND TERMS

A. Whether Timeshare/Sublease Is Possible

The prime lease may require the prime landlord's consent to timeshare all or any portion of the prime leased premises to a third party. Therefore, the provider wanting to sublease part of its space should discuss with the prime landlord the possibility of subleasing the prime leased premises and whether the prime landlord would be amenable to consenting to the timeshare. Many prime leases contain provisions that require that any consent request include a copy of the timeshare document, so the sublandlord and subtenant will need to negotiate and, sometimes, execute the timeshare prior to obtaining the prime landlord's consent. In most cases, though, the sublandlord should discuss the timeshare with the prime landlord *prior* to taking the time and incurring the expense of negotiating a timeshare agreement. To protect a negotiated arrangement, the timeshare agreement should provide that either: (a) the effectiveness of the timeshare is conditioned on obtaining the consent of the prime landlord; (b) either party may terminate, as its sole remedy, if the prime landlord does not provide consent by a date certain.

Sometimes, the prime lease may provide that the prime landlord has the right to terminate the prime lease as to the timeshared premises and "recapture" such space if the prime tenant requests the prime landlord's consent to a timeshare. The recapture right may permit the prime landlord to terminate the entire prime lease when only a portion of the prime leased premises is to be timeshared. Be sure to review the exact language of the prime lease regarding the prime landlord's recapture right, as prime landlord's right may be triggered by *any* type of timeshare request.

On the off chance the prime lease is silent regarding the right of the tenant to assign the lease or timeshare the leased premises, the lease is freely assignable. Texas, however, is unique. In Texas, if the lease is silent regarding the right of the tenant to assign the lease or timeshare the leased premises, assignment or subleasing is prohibited without landlord's consent. Further, in Texas, absent language in the lease to the contrary, nothing requires the landlord to act reasonably in its decision on whether to consent.

B. **RENEWAL RIGHTS**

Any renewal rights granted to the subtenant under the timeshare agreement are subject to the renewal right of the sublandlord under the prime lease. Under some prime leases, the renewal option cannot be exercised if all or a

portion of the prime leased premises has been timeshared. It is critical to the subtenant that the sublandlord be required to exercise its renewal option under the prime lease if the subtenant exercises its right to renew the term of the timeshare. In drafting the timeshare, it is important to keep in mind timing of exercise of renewal rights and rental rates upon renewal:

1. *Timing.* The sublandlord should allow sufficient time to exercise its renewal option under the prime lease after receiving notice from the subtenant of subtenant's exercise of the renewal option under the timeshare. This means that the time for providing notice of subtenant's exercise of the renewal option needs to be earlier than the date for notice required in the prime lease. The more likely scenario, however, is that the rent payable under the timeshare and the prime lease will be due on the same day, which means that the sublandlord will be required to pay the prime landlord rent under the prime lease before it receives the rent from the subtenant.
2. *Renewal Rental Rates.* The parties should review the prime lease to determine whether it contains any rental provision for the rental rate to change or increase during any renewal terms. If so, the sublandlord will want to pass such increase through to the subtenant. If the rental rate for the renewal term under the prime lease is to be "fair market," the subtenant will want to be involved in the process for determining the fair market rent because, most likely, such rent amount will be passed through to the subtenant (especially true in the health care context). If the tenant under the prime lease has the right to revoke its exercise of the renewal option if the parties cannot agree on the fair market rental rate, then the timeshare should provide that the sublandlord will not revoke its exercise of the renewal option if the subtenant does not intend to revoke its exercise of the renewal option under the timeshare or if the subtenant agrees to pay the rental rate determined by the prime landlord (even though the sublandlord may not agree with the amount determined). The timeshare should clearly set forth the role that the subtenant will play in the decision regarding rental rate under the prime lease, how such rental rate affects the rent under the timeshare, and what rights the subtenant has to revoke the exercise of its renewal option. Subtenant's rights regarding the fair market rental determination process may be included in any recognition agreement obtained from the prime landlord.

C. *RENT*

As discussed above, some prime leases may require that the tenant pay the prime landlord all or a portion of any rent received from a subtenant that is in excess of the rent payable under the prime lease. Because the sublandlord will want to have received the rent due from the subtenant under the timeshare prior to paying the rent under the prime lease, the timeshare should provide that the timeshare rent is due on a date earlier than the date the rent under the prime lease is due. The more likely scenario, however, is that the rent payable under the timeshare and the prime lease will be due on the same day, which means that the sublandlord will be required to pay the prime landlord rent under the prime lease before it receives the rent from the subtenant.

In addition to rent, the subtenant should be required to pay its prorata share of the common area maintenance costs. In a multi-tenant property, the prime landlord (and not the sublandlord) is in control of the common area maintenance, repairs, expenses, etc. Thus, certain provisions in the prime lease related to common area expenses cannot be incorporated into the timeshare because the sublandlord is not able to perform the obligations that the prime landlord is required to perform. To address this disconnect, the timeshare should provide that the sublandlord will assign its audit rights to the subtenant, or, if audit rights are not assignable, that the sublandlord will perform an audit on behalf and at the cost of the subtenant. In a single-tenant lease situation, the prime lease will likely not include common area maintenance language, so the parties will need to add standard common area maintenance provisions regarding payment by the subtenant of a prorata share of such costs.

The obligation of the tenant under the prime lease to provide a security deposit to the prime landlord should not be passed through to the subtenant. The sublandlord should evaluate the subtenant's financial strength to

determine independently whether the sublandlord needs to require a security deposit from the subtenant. If the timeshared premises is less than the prime leased premises, the security deposit required to be paid by the subtenant will likely be less than the security deposit paid by the sublandlord as tenant under the prime lease. Sublandlords should be careful if requiring a security deposit that is less than the security deposit paid by it under the prime lease because if the subtenant defaults under the timeshare (and causes the sublandlord to default under the prime lease), the sublandlord's loss of its security deposit may not be covered by the security deposit obtained from the subtenant.

D. DEFAULT

A default by the subtenant under the medical timeshare may cause a default by the sublandlord under the prime lease, so the parties need to consider the relative liability and limitations on liability of the parties related to the potential damage that may be incurred by the non-defaulting party. When working through default provisions, whether by subtenant or sublandlord, the parties should ensure that appropriate remedies and obligations flow down from the prime lease. For example, notice and opportunity to cure options as well as direct lease options between subtenant and prime landlord could alleviate inadvertent default situations.

E. LIABILITY CONCERNS

If the prime lease includes indemnity provisions, the sublandlord will want to make sure that the subtenant's indemnity obligation covers *both* the sublandlord and the prime landlord to the extent of sublandlord's indemnity obligations under the prime lease. Any indemnification by prime landlord of tenant under the prime lease should not be extended by incorporation of the prime lease by reference to be an indemnification by sublandlord of subtenant under the timeshare because the sublandlord may not have any responsibility for, control over, or insurance coverage for, the matters for which prime landlord is indemnifying sublandlord (for example, claims arising in connection with the common areas, which, for sublandlord, would be an uninsured risk). Any indemnity by sublandlord should be narrowly drafted to cover only sublandlord's obligations under the timeshare and not prime landlord's obligations under the prime lease. Moreover, the subtenant should request certain exclusions from its indemnification of sublandlord and prime landlord, such as liability of the sublandlord existing prior to the effective date of the timeshare or environmental or other conditions that exist prior to the effective date of the timeshare.

To further protect interests, sublandlord will want to require the subtenant to maintain at least the same insurance required to be maintained by sublandlord, as tenant, under the prime lease, but limited to the timeshared premises. But a small amount of timeshare space may make maintaining the same insurance coverage amounts required under the prime lease overkill or too costly for the subtenant, relative to the size of the timeshared premises. The parties should carefully review the allocation of insurance for alterations and tenant improvements, as those relate to the timeshared premises versus the remainder of the prime leased premises.

The parties can pass-through the waiver of subrogation from the prime lease to the timeshare; however, it is better to have separate waivers of subrogation and releases in the timeshare agreement in order to more clearly identify the parties and each of their respective waivers, releases, and obligations. Note that the prime landlord's waiver of subrogation will not benefit the subtenant and the subtenant's waiver of subrogation will not benefit the prime landlord, unless expressly stated. Therefore, the prime landlord's insurer could pursue subrogated rights against the subtenant (and vice versa). The subtenant and prime landlord should request specific waiver of subrogation in the prime landlord's consent instrument or in a recognition agreement.

In many prime leases, the prime landlord's liability is limited to its interest in the leased premises or in the building in which the leased premises is located. When representing a subtenant, such provision should not be passed-through to the timeshare because the sublandlord's interest in the timeshared premises or in the building is only its

leasehold interest pursuant to the prime lease; an interest with no value once the prime lease terminates. Thus, if the prime lease is terminated, the sublandlord's interest is nothing, and the subtenant could find itself in the position of having no viable recourse against the sublandlord. If the sublandlord insists on a limitation of liability, consider an amount certain.

F. MAINTENANCE AND REPAIR OBLIGATIONS; ALTERATIONS

Different considerations are required depending on whether the building is a multi-tenant or single-tenant building and whether the timeshared premises is a portion of the entire prime leased premises. Keep in mind when referencing the prime lease that some of prime landlord's obligations under the prime lease cannot be completed by the sublandlord (such as common area maintenance or structural repairs and capital improvements) and some obligations of the tenant under the prime lease should not become obligations of the subtenant (such as maintaining any portion of the prime leased premises that is not within the timeshared premises).

In a single-tenant building, the prime lease will likely require that the tenant maintain and repair all non-structural portions of the building, and possibly some structural, mechanical, electrical, plumbing, and HVAC systems. These obligations of the tenant under the prime lease can be passed-through in their entirety to the subtenant. The sublandlord may not be able to assume all the obligations of the prime landlord (such as structural repairs), and those obligations should be excluded from the pass-through provisions.

In a multi-tenant building, the prime landlord and tenant will likely divide certain maintenance and repair obligations, depending on the extent that the maintenance or repairs would benefit the tenant exclusively (e.g., the leased premises) or all tenants of the building (e.g., the common areas). The obligations of the tenant under the prime lease should be passed-through to the subtenant, but the obligations of the prime landlord should not pass through as obligations of the sublandlord. Sublandlord can only agree to use commercially reasonable efforts to notify the prime landlord of the need of repairs and maintenance and to enforce its rights against the prime landlord under the prime lease. Should the prime landlord enter into a recognition agreement, subtenant should obtain the prime landlord's agreement to maintain and repair the building and common areas in accordance with the prime lease. Moreover, the timeshare agreement needs to clearly identify that the sublandlord will maintain and repair the remainder of the prime leased premises because failure to maintain the remainder of such space could affect the use of the timeshared premises and would be a default by the sublandlord under the prime lease.

As for alterations, the prime lease likely will require prime landlord's consent for certain alterations to the prime leased premises. The subtenant should try to negotiate that if the prime landlord consents to alterations to the timeshared premises, the sublandlord will be deemed to have consented. This will prevent the subtenant from needing consent from two different parties. The counter should also be true—if the prime landlord denies consent, sublandlord should be deemed to have denied its consent.

G. HOLDOVER AND SURRENDER

Sublandlord should be wary of the possibility that a holdover by the subtenant as to the timeshared premises would cause a holdover by the sublandlord of the entire prime leased premises. Therefore, the sublandlord will want to negotiate that the subtenant's liability for holding over in the timeshared premises includes all of the holdover liability of sublandlord under the prime lease. In addition, the sublandlord should provide itself with a margin of safety in the event that the subtenant holds over to cover additional costs related to subtenant's holdover, such as defense costs. If the sublandlord requires this margin of safety, the subtenant may be able to negotiate to pay the greater of (i) the higher holdover rent, or (ii) the holdover rent payable under the prime lease; however, subtenants need to be careful with this concept in cases where the timeshared premises is less than the entire prime leased premises. Consideration regarding timing needs to be taken into account, such that the subtenant is required to vacate the prime leased premises prior to the date that the tenant is required to vacate the

prime leased premises under the prime lease. This will allow the sublandlord time to prepare the timeshared premises in the required surrender condition if the subtenant does not do so.

Note that permitting a surrender under the timeshare (or having the term of the timeshare expire prior to the term of the prime lease) may result in a breach of any continuous operation covenants under the prime lease. The subtenant should be concerned with obligations to remove tenant improvements that pre-existed the timeshare, since this could be a costly endeavor for the subtenant.

In the health care context, parties should take extra precaution to ensure that holdover terms are consistent with the same terms and conditions found in the preceding rental arrangement. Because any changes to holdover terms may be viewed as a compliance risk with regards to the Stark Law and the AKS, parties should avoid amending the terms and conditions of an arrangement during a holdover. While a preceding arrangement may have been consistent with fair market value and commercially reasonable standards, the parties should ensure that the holdover terms satisfy all the elements of the applicable exception relied on in the preceding rental arrangement, and continue to do so on an ongoing basis.

For example, if a medical office space rental's rate is fair market value during the term of the lease, but the rate falls below fair market value during the holdover period, the entire lease arrangement could, consequently, fail to satisfy the applicable exception. Further, parties should be wary of any holdover premiums charged by the landlord or sublandlord, in that these charges need to be explicitly set out in advance in the applicable lease documents at the time of execution and that the rental rate plus the holdover premium remain consistent with fair market value. Additionally, the failure by a landlord or sublandlord to enforce any holdover premiums, to the extent these are included in the original prime lease or timeshare, would not meet the requirement that the holdover arrangement continue on the same terms and conditions as the preceding arrangement. A failure to collect these charges may also constitute a forgiveness of debt, thereby creating a secondary financial relationship between the parties that must satisfy an applicable exception under the Stark Law or AKS.

H. CASUALTY AND CONDEMNATION

The sublandlord's right to terminate the prime lease due to casualty or condemnation should be passed-through to the subtenant (as it relates to the termination of the timeshare); however, the provisions in the prime lease should be reviewed carefully to avoid a situation where the timeshared premises is too small a portion of the prime leased premises to trigger the termination right under the prime lease even if all of the timeshared premises is damaged by the casualty or taken in a condemnation.

Any rent abatement provided to the tenant under the prime lease may be passed-through to the subtenant depending on the negotiating power of the subtenant. If such right passes through to the subtenant without the qualifier discussed below, a situation may arise where the subtenant is entitled to rent abatement under the timeshare but the sublandlord is not entitled to rent abatement under the prime lease (e.g. if a substantial portion of the timeshared premises is damaged by a casualty but only a minor portion of the prime leased premises is damaged, and rent abatement under the prime lease is based on a threshold of area damaged). The sublandlord should qualify the pass-through of rent abatement so that the subtenant receives an abatement only to the extent that sublandlord actually receives rent abatement under the prime lease; however, the subtenant will likely negotiate for the right to rent abatement regardless of whether sublandlord actually receives abatement under the prime lease.

The obligation of restoring the timeshared premises following a casualty or condemnation should be similar to the obligation of restoration under the prime lease, but remember that because sublandlord most likely does not have the right or obligation under the prime lease to restore the prime leased premises following a casualty or condemnation, it can only be tasked with the obligation to be the "enforcer" of such obligations of the prime

landlord. Be sure to limit the obligation to restore the timeshared premises to only instances where the prime landlord's restoration obligations are triggered under the prime lease.

V. PRIME LANDLORD CONCERNS

Prior to execution of a consent to timeshare, the prime landlord should review the timeshare agreement and any information regarding the subtenant (including financial information). For clarity purposes, the copy of the final and complete timeshare agreement should be attached to the consent. The prime landlord should try to obtain the representations stated below.

Again, a consent to timeshare does not create privity of contract between prime landlord and subtenant and should not increase any liability or obligations of prime landlord under the prime lease. As discussed above, the subtenant may want the prime landlord to consider a recognition agreement to ensure that the prime landlord recognizes subtenant's occupation rights and agrees not to extinguish such right in the event of the termination of the prime lease so long as the subtenant agrees to be bound by the terms of the prime lease. A recognition agreement should contain provisions allowing the subtenant to enforce certain obligations of the prime landlord (such as repair and maintenance obligations and restoration obligations) and provisions regarding subtenant's rights in the event that the sublandlord defaults under the prime lease. The recognition agreement can also provide that in the event prime landlord intends to sell the building in which the prime leased premises is located, the subtenant will cooperate in providing estoppels and any due diligence items.

Other items to address for prime landlord concerns include:

- Sublandlord and subtenant should represent to the prime landlord that the timeshare agreement provided to prime landlord for review is the final and complete copy of the timeshare agreement.
- The amount of rent payable under the timeshare should be confirmed in the event that the prime landlord is entitled to a portion of the rents paid to sublandlord in excess of the rent paid under the prime lease.
- Subtenant should represent that the financial information provided to the prime landlord is accurate because, in many cases, the prime landlord is relying on the financial strength of the subtenant in determining whether to consent to the timeshare. Subtenant should agree to provide additional financial information upon request by prime landlord.
- Prime landlord should try to obtain estoppel-like representations from the sublandlord and subtenant, confirming that the prime landlord is in compliance with the terms of the prime lease, and there are no defenses or offset rights to sublandlord's obligations under the prime lease, as the tenant thereunder.
- Prime landlord should obtain confirmation from the sublandlord and subtenant of the legal relationship among the parties and documents: (a) the timeshare is subject to and subordinate to the prime lease; (b) a violation under the timeshare is a violation under the prime lease; (c) the prime lease and the relationship between prime landlord and sublandlord are not altered by the timeshare; (d) prime landlord is not bound by the terms of the timeshare; (e) subtenant does not have the right to enforce any terms of the timeshare against the prime landlord; and (f) sublandlord, as tenant under the prime lease, is not released from any obligations under the prime lease.
- Prime landlord will want to negotiate certain covenants into a recognition agreement or consent if these are not already included in the timeshare: (a) subtenant cannot further timeshare the timeshared premises or assign the timeshare; (b) timeshare may not be amended without the consent of the prime landlord; (d) any notices of default in connection with the timeshare shall be delivered to prime landlord; (e) subtenant will provide an estoppel certificate upon request of prime landlord; (f) indemnification from subtenant; and (g) waiver of claims by the subtenant and agreement by the subtenant as to certain insurance requirements (such as naming prime landlord as an additional insured).

VI. LENDER CONCERNS

Keep in mind that the prime landlord's lender's consent may also be required for the timeshare. Whether a lender's consent is required will depend on the lender's lease approval rights in the loan documents. While a timeshare of the timeshared premises may be considered a minor lease under the loan documents that does not require lender's consent, lender's consent may still be required if the timeshared premises is a portion of the prime leased premises of a major lease. A lender will want to consider whether having unoccupied space in its collateral is better (or worse) than having a timeshare structure. In such consideration, the lender will need to consider the financial viability of the subtenant. A subtenant that timeshares a substantial amount of space will likely want a subordination, non-disturbance, and attornment agreement (SNDA) from the lender. Although the lender has no obligation to provide an SNDA, most lenders will be reasonable with respect to providing an SNDA to such subtenant. A sublandlord should be wary of agreeing in the timeshare agreement to provide the SNDA because the sublandlord has no privity of contract with the lender and will need to work through the prime landlord to obtain the SNDA.

VII. HEALTH CARE FAIR MARKET VALUE CONSIDERATIONS

Real estate lease arrangements in the health care context, especially medical timeshares, carry additional legal and regulatory considerations, presenting further opportunities for compliance pitfalls. Lease arrangements between health systems, health care practitioners and potential referral sources potentially implicate fraud and abuse laws, including, but not limited to, the Stark Law and the AKS. Typically, arrangements in this context must fall under an applicable Stark Law exception and AKS safe harbor, namely the space or equipment rental exception or safe harbor, respectively.

The Stark Law and AKS require components of medical timeshare to be documented at fair market value. They also require a medical timeshare to be structured to meet the following:

- Written agreement that specifies premises and equipment covered;
- Written agreement with a lease term of at least one year;
- Provision of space and equipment in the lease that do not exceed that which is reasonable and necessary for legitimate business purposes;
- Space and equipment is used exclusively by lessee and not shared with anyone related to lessor, with the exception of the designated common areas;
- If the lease provides use for periodic intervals, the agreement specifies the exact schedule of such intervals, including a precise length and exact rent; and
- Aggregate rent is set in advance, consistent with fair market value, and not determined in any manner that reflects volume or value of referrals or other business generated between parties

Under the space and equipment lease exceptions, the Stark Law allows physicians, health care facilities, and medical groups to share space, among other items, provided that the arrangement is in writing and specifies the items or space to be shared (including the exact times and dates of use), is between a physician (or group) and a hospital or a physician organization of which the visiting physician is not an owner, employee or contractor, and the premises covered by the arrangement is used primarily for evaluation and management services to patients (note, this exception typically will not apply to a physician using a space primarily to furnish designated health services versus evaluation and management services).⁶

The other requirements of the lease exception track most of the other Stark Law exceptions (e.g., fair market value remuneration and commercial reasonableness of the overall arrangement). Medical timeshares are typically used for physicians that only need use of an office part-time or on specific days. When calculating the fair market value in medical timeshares, subtenants should consider all the space, equipment, personnel and services required for

the medical practice to function. Often, subtenants fail to consider the value of the common areas and the value of the equipment, personnel, and services provided under the timeshare arrangement. The parties should document how each of the applicable items factor into the arrangement and support the fair market value nature of the arrangement.

Failure to factor these in could result in rental terms that are not consistent with fair market value or commercial reasonableness. Additionally, failure to include these in the fair market value calculation and failure to specifically mention them in the lease agreement could be construed as creating a secondary financial relationship between the parties, especially when a referral relationship is involved.

VIII. COMMON PITFALLS WITH THE STARK LAW RENTAL EXCEPTION OR OFFICE SPACE SAFE HARBOR

Finally, we cannot stress enough the importance of evaluating certain aspects of medical timeshares when the parties are in a position to refer patients or generate business for each other. When taking such steps, parties should avoid the following pitfalls:

- A. ***Fair Market Value Comparison.*** A common pitfall when evaluating fair market value is to compare the rates of a medical office building with the rates found in general office buildings. Instead, medical office building rates should be compared to other comparable medical office buildings, as these facilities typically result in higher rental rates when compared to general office buildings. Subtenants should evaluate whether the fair market valuation found in the prime lease and the timeshare is derived correctly, and review their rights to renegotiate such terms.
- B. ***Rental Rate Escalators.*** Subtenants should pay special attention to any rental escalator provisions (or lack thereof) in the prime lease or renewal terms and the timing at which such escalators cause rent to change. A lack of rental escalators in a long-term lease may automatically raise commercial reasonableness questions if their inclusion is consistent with the local health care market. Additionally, long-term leases with no rental escalators may have rates that initially qualify as fair market value, but that miss that mark in subsequent years. Subtenants should pay special attention to the fair market value of their rental rates and how rental escalators affect the determination of fair market value rental rates in both the prime lease and timeshare.
- C. ***Rent Abatements.*** Subtenants should also pay close attention to any rent abatements included in the prime lease or timeshare. Rent abatements are typically market specific; therefore, including (or omitting) them in a lease that causes deviation from other health care facilities' leases in the area may affect the commercial reasonableness of the lease. If rent abatements are included in the prime lease and/or timeshare, the subtenant should be sure to account for the abated rent amount in its fair market value analysis.
- D. ***Tenant Improvement Allowance.*** Subtenants should review the prime lease and timeshare to determine their rights as to any tenant improvement (TI) allowances, how they relate to the timeshared premises versus the prime leased premises, and whether the right remains with the sublandlord. Subtenants should factor in TI allowances in their fair market value calculations, especially when the subtenant is only leasing part of the premises. Failure to include these in a fair market value analysis can result in below market rent. The subtenant should also review any TI allowances for commercial reasonableness, and special care should be taken to compare the TI allowance to lessees in similar *health care* settings. For example, health care facilities and medical office buildings may require reinforced walls to protect from radiation, extra plumbing to install sinks in different exam rooms, and other such similar improvements that deviate from a traditional retail lessee's needs. Finally, a medical timeshare may raise compliance concerns if the subtenant is obligated for improvement costs above the TI allowance, but the landlord (in a referral relationship) fails to charge or collect these extra costs.

¹ Timeshares may not be available if one or more of the health care providers is classified under Medicare as an Independent Diagnostic Testing Facility or “IDTF.” Except for hospital-based and mobile IDTFs, IDTF rules prohibit sharing of space and equipment between an IDTF and another Medicare-enrolled provider type. *See* 42 C.F.R. § 410.33(g)(15).

² *See, e.g.*, 42 U.S.C. § 1395nn and implementing regulations at 42 C.F.R. § 411.351 *et seq.*

³ *See* 42 U.S.C. § 1320a-7b(b) and its safe harbor regulations at 42 C.F.R. § 1001.952.

⁴ For purposes of this article, we assume that most timeshare arrangements will involve parties who have the potential to refer patients between them and who participate in Medicare, which creates the compliance obligations under the Stark Law and AKS. Please remember that AKS actually applies to a broader scope of federal governmental health care programs (Medicare, Medicaid, TRICARE, Title V Maternal & Child Health Services Block Grant Program, and Title XX Social Services Block Grant program) than the Stark Law, which generally applies only for arrangements that include referrals of “designated health services” payable by Medicare.

⁵ *See* 31 U.S.C. §§ 3729-3730.

⁶ *See* 42 C.F.R. § 411.357(a), (b) (outlining the requirements for space and equipment leases); similar requirements for AKS can be found at 42 C.F.R. § 1001.952(b), (c).