§ 411.359(g) in regard to arrangements that are incident to the physician's ownership. Examples of such arrangements are the initial offer to allow the physician to acquire the ownership interest, dividends paid to the physician as an owner, or the opportunity to enter into a stockholders agreement that would provide for the buyout of the physician's ownership on death, disability, retirement, etc., or that provides the hospital with a right of first refusal to buy the physician's ownership interest in a hospital.

Response: We believe that the commenter has asked about compensation arrangements that are inherent in certain ownership/ investment situations for which there are exceptions under the proposed regulation. We believe that a return on equity (for example, dividends) that a physician gets as a consequence of being an owner is not considered a

compensation arrangement.

We take this position because section 1877 is designed to prohibit referrals to an entity whenever a physician has a financial relationship with that entity. The purpose is to prevent physicians from realizing a financial gain or some other benefit from making those referrals. The Congress specifically defined "financial relationship" to include two distinct components: an ownership/investment interest and a compensation arrangement. By this, we believe the Congress meant to encompass two mutually exclusive concepts: (1) Investment/ownership interest and whatever potential compensation or value they have or may bring to the owner, and (2) all other arrangements that result in some compensation.

Since we believe that potential compensation from an ownership/ investment interest is already factored into the investment/ownership exceptions, it would make little sense to review the resulting compensation against the exceptions for compensation arrangements. For example, it would make little sense to say that a physician can invest in publicly traded securities under the ownership/investment exception in section 1877(c), yet preclude the physician's referrals because the compensation he or she receives from these investments does not fall within any of the compensation exceptions. As a result, the prohibition on referrals should apply only when a physician has a compensation arrangement that results from something other than an excepted ownership or investment interest. It is to these compensation arrangements, which do not stem from an ownership or

investment interest, that the compensation exceptions apply. Thus, we agree that a physician would not be required to qualify for both exceptions in order to refer laboratory tests to the laboratory in which he or she has an ownership interest.

G. Exceptions to the Referral Prohibition Related to Compensation Arrangements

1. Rental of Office Space

Section 411.359(a) of the proposed rule describes the exception under which the rental of office space does not constitute a financial relationship subject to the prohibition on referrals. The exception applies as long as payment made by a lessee to a lessor is made under the following conditions:

- · There is a rental or lease agreement that meets the following requirements:
- + The agreement is set out in writing and is signed by the parties.
- + The agreement identifies the premises covered by the agreement and specifies the space dedicated for the use of the lessee.
- + The term of the agreement is at least 1 year.
- + If the agreement is intended to provide the lessee with access to the premises for periodic intervals of time, rather than on a full-time basis for the term of the agreement, the agreement specifies exactly the schedule of the intervals, their precise length, and the exact rent for the intervals.
- + The agreement provides for payment on a periodic basis of an amount that is consistent with the fair market value of the rented or leased premises in arm's-length transactions.
- + The agreement provides for an amount of aggregate payments that does not vary (directly or indirectly) on the basis of the volume or value of any referrals generated between the parties.
- + The terms of the agreement would be considered to be commercially reasonable even if no referrals were made between the lessee and the lessor.
- · If an interested investor (either a physician or immediate family member) has an ownership or investment interest in the rented or leased office space, the arrangement meets the following conditions:
- + The rented or leased office space is in the same building in which the physician's practice or the physician's group practice is located.
- + All of the requirements described in paragraphs (a)(1)(i) through (a)(1)(vii) of § 411.359 are met.

Section 1877(e)(1) as enacted by OBRA '89 was significantly changed by OBRA '93. Section 152(c) of SSA '94 amended the effective date provision for OBRA '93 so that the amendments to the rental exception are effective retroactively to January 1, 1992. The OBRA '93 provisions for the rental of office space provide that payments made by a lessee to a lessor for the use of a premises shall not be considered a compensation arrangement if-

 The lease is set out in writing, signed by the parties, and specifies the premises covered by the lease.

- The space rented or leased does not exceed that which is reasonable and necessary for the legitimate business purposes of the lease or rental and is used exclusively by the lessee when being used by the lessee, except that the lessee may make payments for the use of space consisting of common areas if such payments do not exceed the lessee's pro rata share of expenses for such space based upon the ratio of the space used exclusively by the lessee to the total amount of space (other than common areas) occupied by all persons using such common areas.
- The lease provides for a term of rental or lease for at least 1 year.
- The rental charges over the term of the lease are set in advance, are consistent with fair market value, and are not determined in a manner that takes into account the volume or value of any referrals or other business generated between the parties.
- The lease would be commercially reasonable even if no referrals were made between the parties, and
- The lease meets such other requirements as the Secretary may impose by regulation as needed to protect against program or patient

Comment: A number of commenters raised questions about the meaning of the "same building" requirement in section 1877(e)(1)(B). Prior to OBRA '93, section 1877(e)(1)(B) stated that, "in the case of rental or lease of office space in which a physician who is an interested investor (or an interested investor who is an immediate family member of the physician) has an ownership or investment interest, the office space is in the same building as the building in which the physician (or group practice of which the physician is a member) has a practice." Several commenters also questioned the meaning of the terms "investor," "interested investor," and "disinterested investor" in section 1877(h) (5) and (6).

Response: OBRA '93 amended section 1877(h) to eliminate the terms "investor," "interested investor," and "disinterested investor." In addition, OBRA '93 eliminated the "same building" requirement in section 1877(e)(1)(B), effective January 1, 1995.