CLIENT ALERTS & INSIGHTS

Earnout Held to Violate NY Fee Splitting Prohibition

AUGUST 14, 2024

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A pivotal decision by a New York Appellate Division court holding that earnouts based on the future revenue of a dental practice violated the NY Fee Splitting Prohibition could substantially impact the structuring of health care professional practice transactions in New York.

The Appellate Division’s ruling in *Advanced Dental of Ardsley, PLLC v. Brown*[1] underscores the critical need for compliance with New York Education Law §§ 6509-a and 6530(19) (the “NY Fee Splitting Prohibition”), signaling potential heightened scrutiny and enforcement that could impact the structure of healthcare transactions in New York moving forward.

Initial Action

In February 2015, Advanced Dental of Ardsley, PLLC (“Plaintiff”) entered into an Asset Purchase Agreement (“APA”) with Theodore Brown, a licensed dentist with his own separate practice (“Defendant’). Under the APA, Plaintiff sold certain assets of its dental practice to Defendant for up to $250,000 (the “Purchase Price”).

Defendant agreed to pay approximately $50,000 in two fixed payments, with the remainder of the Purchase Price to be paid in monthly installments based upon (a) a percentage of the future monthly revenue generated by Plaintiff’s practice; plus (b) if certain conditions were met, a percentage of the future revenue from Defendant's separate practice that was not part of the transaction.

In March 2022, Plaintiff sued Defendant for breach of contract and unjust enrichment. However, Defendant moved to dismiss on the basis that, in part, the APA constituted an illegal arrangement under the NY Fee Splitting Prohibition.

The lower court initially denied the motion to dismiss, suggesting that the APA's earnout provision did not constitute illegal fee-splitting and was instead “merely a formula-based provision to schedule payment of the purchase price.”

Reversal of Lower Court Opinion on Fee-Splitting and Earnout Provisions

The Appellate Division reversed the lower court’s decision primarily relying on Defendant’s NY Fee-Splitting Prohibition argument. The Appellate Division determined that the arrangement requiring Defendant to pay a percentage of future revenue generated by Plaintiff's practice after the sale of the practice constituted a prospective agreement for splitting fees, violating the NY Fee Splitting Prohibition and rendering the entire agreement unenforceable.

The Appellate Division cited *Sachs v. Saloshin*[2] and *Hartman v. Bell*[3], two New York precedent cases from 1988, to support the position that agreements involving fee-splitting between licensed professionals are illegal and unenforceable.

Hartman v. Bell also held that the terms of a sale of a professional practice between professionals violated the NY Fee Splitting Prohibition where the "purchase price" was not specified, but instead was wholly reliant on a percentage of future revenue of the practice.

The *Advanced Dental* decision arguably broadens the scope the NY Fee Splitting Prohibition because the purchase price at issue was not wholly reliant on a percentage of future revenue of the acquired practice. Instead, the future revenues were only used to determine the portion of a fixed, set in advance price to be paid by the purchaser as a month installment. The future revenues of the practice did not affect the total amount to be paid to the seller.

Nevertheless, the Appellate Division held that the NY Fee Splitting Prohibition still applied where a portion of the purchase price to be paid was dependent upon the future revenue of the dental practices.

Implications for Future Transactions and Legal Scrutiny

The *Advanced Dental* decision may signal an increased trend of enforcement and scrutiny regarding earnout distributions and similar purchase price structures in health care transactions in New York in the near future.

The Appellate Division's decision serves as a critical reminder of the legal complexities surrounding compensation arrangements in professional practice transactions and reinforces the need for compliance with these strict legal standards to avoid nullification of agreements and potential legal liabilities.

We recommend carefully scrutinizing purchase and sale agreements to ensure that the purchase price or other compensation for a medical, dental, or other professional practice does not involve arrangements that could be interpreted as prohibited revenue sharing or fee splitting. By taking proactive steps to ensure compliance, buyers and sellers can mitigate risks and navigate the evolving legal landscape effectively.

The Benesch Healthcare+ team monitors developments in this area of the law and may provide additional updates as they become available. Please contact the authors of this article for additional information or if you have any questions.

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[1] *Advanced Dental of Ardsley, PLLC v. Brown*, No. 2023-00812, 2024 WL 3434226 (N.Y. App. Div. July 17, 2024).

[2] *Sachs v. Saloshin*, 138 A.D.2d 586, 526 N.Y.S.2d 168 (1988).

[3] *Hartman v. Bell*, 137 A.D.2d 585, 524 N.Y.S.2d 477 (1988).