Case No.: S236208

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

HELLER EHRMAN LLP,

Plaintiff and Petitioner,

vs.

DAVIS WRIGHT TREMAINE LLP,

Defendant and Respondent.

AND RELATED CASES

SUPREME COURT
FILED

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AFTER A DECISION BY THE NINTH CIRCUIT COURT OF APPEAL
CASE NOS. 14-14314/14-16315/14-16317/14-16318

APPEAL FROM THE U.S. DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION,
CASE NOS. 14-01236/14-01237/14-01238/14-01239

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QUESTION PRESENTED

Under California law, what interest, if any, does a dissolved law firm have in legal matters that are in progress but not completed at the time the law firm is dissolved, when the dissolved law firm had been retained to handle the matters on an hourly basis?
(Order Granting Request to Decide Question of State Law, Aug. 31, 2016.)

INTRODUCTION

The California Uniform Partnership Act of 1994[1] (generally referred to as "RUPA"), in which the Legislature built upon over one hundred years of case precedent and California's prior version of the uniform partnership act (known as "UPA"), governs the answer to this question. A dissolved law firm is entitled to recover for the benefit of its creditors and its partners the profits generated by any partners of the dissolved firm from completing hourly fee matters that were in progress but not completed when the firm dissolved, less reasonable compensation and an allocation of overhead.

California Corporations Code section 16404(b)(1) obligates each partner of a dissolving partnership "[t]o account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct or winding up of the partnership business . . . " No partner is entitled to any compensation for completing partnership business, except for reasonable compensation for services rendered in winding up the business of a partnership. As the Court of Appeals have held repeatedly in interpreting the UPA's nearly identical provisions, the duty to account requires a partner to

[1] California Corp. Code §§ 16100 – 16692.

account for the "attorneys' fees received on cases in progress upon dissolution of a law partnership." (E.g., *Jewel v. Boxer* (1984) 156 Cal.App.3d 171, 174; *Rothman v. Dolin* (1993) 20 Cal.App.4th 755.)

This principle, known as the "Unfinished Business Rule," existed as a matter of common law well before the UPA was enacted in 1929. (*Denver v. Roane* (1878) 99 U.S. 359; *Osment v. McElrath* (1886) 68 Cal. 466; *Little v. Caldwell* (1894) 101 Cal. 553.)

The Unfinished Business Rule recognizes that cases and matters brought into a law firm are the products of the efforts of the partnership as a whole and is built on long-established and basic partnership principles. The duty to account for the profits from pending but uncompleted legal matters at the date of dissolution could have been available for the estate of Heller Ehrman LLP ("Heller") to collect on behalf of its creditors (including its former employees, associates, and retired partners). (See Cal. Corp. Code, § 16807(a)) (specifying that in the winding up of a partnership's business, available assets should be distributed first to the partnership's creditors, then to partners). But the partners of Heller, as part of the plan of dissolution, included a "*Jewel* Waiver" that purported to "waive" the firm's right to collect the profits from unfinished hourly business matters.

Heller filed the four related cases at issue challenging the *Jewel* Waiver as a fraudulent transfer under applicable federal bankruptcy laws. Heller contends that the four Law Firm Respondents here are liable as subsequent transferees to account for the profits earned from Heller's hourly unfinished business matters. Heller's motion for summary adjudication on liability issues was granted by the

bankruptcy court. The cases were later withdrawn to the district court for trial. The district court first reviewed the bankruptcy court's ruling granting summary judgment and reversed, which gave rise to the Ninth Circuit appeal and its order certifying the question of state law to this Court. (*Heller Ehrman LLP v. Davis Wright & Tremaine LLP (In re Heller Ehrman LLP)* (2016) 830 F.3d 964.)

STATEMENT OF FACTS

I. Heller – The Law Firm.

Founded in 1890, Heller was a prominent law firm that prior to its dissolution was a global law firm of more than 700 attorneys. Appellant's Excerpt of Record ("ER") 6.[2] Heller was organized as a limited liability partnership as stated in its Partnership Agreement dated January 1, 1994 (the "Partnership Agreement"). ER 129. The Partnership Agreement provided that "[a]ll clients for whom any Partner or Member provides legal services shall be clients of the Partnership unless the Policy Committee determines otherwise." ER 130, ¶ 4.5. The Partnership Agreement did not address the allocation of profits from unfinished business completed after dissolution.

Heller had a two-tiered structure, with professional corporations ("Heller PCs") serving as each of Heller's partners. ER 132-133; 134, 135, 136. Each of the Heller PCs had no other operations besides its activities with the Partnership. ER 139-140. The PCs, in turn,

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[2] Heller's citations are to the Appellant's Excerpts of Record filed in the Ninth Circuit Court of Appeals in *Heller Ehrman LLP v. Davis Wright Tremaine LLP*, Ninth Circuit Case No. 14-14314, unless otherwise indicated when Heller is referencing the Excerpts of Record in one of the related cases.

employed attorneys who were also shareholders of the Heller PCs ("Shareholders"). ER 142. These Shareholders controlled and directed Heller through annual shareholder votes and various management committees. ER 140-141.

By the summer of 2008, Heller was deep in debt. It owed millions to its creditors. On August 31, 2008, Heller had approximately $5 million in available cash and bank debt of over $54 million. ER 143. On September 19, 2008, Heller's bank lenders declared a default. ER 144-145. The banks seized control of all available cash and refused to allow Heller to make any further payments (on debts or otherwise) without the banks' permission. ER 148-149. Going forward, the lenders were in control of what payments Heller was allowed to make. ER 148-150. On September 26, 2008, the banks refused Heller's request to "pay debts as they come due." ER 151-152. Heller's Shareholders then voted to approve a dissolution plan ("Dissolution Plan"). ER 153-154.

The Dissolution Plan included a waiver of Heller's rights to the profits earned from the completion of its pending matters. Specifically, Article VI.F of the Dissolution Plan provided:

> [T]he Firm-in-Dissolution [Heller] will waive any rights and claims under the doctrine of *Jewel v. Boxer*, 156 Cal.App.3d 171 (1984)[,] to seek payment of legal fees generated after the departure date of any lawyer or group of lawyers with respect to non-contingency/non-success fee matters only . . . .

ER 155. At the time of the Jewel Waiver, Heller was insolvent and unable to pay its debts as they came due. Heller would soon be forced

to fire virtually all its employees without providing proper notice. ER 157-158. Heller did not receive any consideration or payment of any kind from either the Shareholders or their new firms in exchange for the Jewel Waiver.

II. Heller – Relevant Proceedings Below.

Three months after dissolution, Heller filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. On September 1, 2010, the Joint Plan of Liquidation of Heller Ehrman LLP became effective. Michael Burkart was appointed Plan Administrator with responsibility for pursuing litigation claims to recover assets for the benefit of Heller's creditors.

In December of 2010, Heller filed multiple adversary proceedings[3] seeking to avoid the *Jewel* Waiver as a fraudulent transfer under applicable federal bankruptcy law. Heller sought to recover from the law firms that, as subsequent transferees, received the profits collected on Heller's unfinished business.[4] ER 159-296.

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[3] An adversary action is a lawsuit filed separate from, but related to, the underlying bankruptcy case. The procedures governing adversary actions are outlined in Rules 7001 – 7087 of the Federal Rules of Bankruptcy Procedure.

[4] Heller did not sue the individual Shareholders who were the initial transferees and the first beneficiaries of the *Jewel* Waiver. Instead, it sued the law firms that received the unfinished business from the former Shareholders free from the duty to account for any unfinished business profits as subsequent transferees (11 U.S.C. § 550(a)(2)) or as the entity "for whose benefit the transfer was made" (11 U.S.C. § 550(a)(1)). ER 179, at ¶ 99. The federal law issue of whether the law firms are liable as subsequent transferees under federal bankruptcy law is not before this Court.

Heller's adversary actions followed a prior bankruptcy court decision. (*Greenspan v. Brobeck Phleger & Harrison LLP (In re Brobeck, Phleger & Harrison LLP)* (Bankr.N.D.Cal. 2009) 408 B.R. 318 ["*Brobeck*"].) In *Brobeck*, the court recognized that California courts follow "[t]he unfinished business rule [which] provides that, in the absence of an agreement to the contrary, partners have a duty to account to the dissolved firm and their former partners for profits they earn on the dissolved firm's 'unfinished business,' after deducting for overhead and reasonable compensation." (408 B.R. at 326 [footnote omitted].) The *Brobeck* court also held that "the Jewel Waiver transferred that interest to the Brobeck former partners." (Id. at 338.)

The Heller adversary proceedings have a developed procedural history.

Heller I (MTD): Sixteen law firm defendants filed motions to dismiss[5] arguing, among other things, that (1) the *Jewel* Waiver did not fraudulently transfer any property; (2) the Shareholders in the professional corporations that were the partners of Heller were not subject to RUPA; and (3) California Rules of Professional Conduct or public policy preclude applying the Unfinished Business Rule to law firm partnerships. The Bankruptcy Court held a consolidated hearing and issued a uniform decision, ER 106, n.3., as it also did in subsequent proceedings. In a comprehensive memorandum decision, the Bankruptcy Court rejected each of the law firm defendants'

[5] Heller was able to settle or resolve many of the smaller matters relatively soon after they were filed. (See *In re Heller Ehrman LLP*, Case No. 08-32514 (Bankruptcy Court, Northern District of California), Docket No. 2123 [Motion to Approve Settlement With Sidley & Austin LLP].)

arguments. It held that valid claims were pled that the *Jewel* Waiver constituted a "transfer" of "an interest in the debtor in property" under 11 U.S.C. section 548(a)(1)(B). See ER 115-26, available at (*Heller Ehrman LLP v. Arnold & Porter LLP (In re Heller Ehrman LLP)*, (Bankr. N.D.Cal., Apr. 22, 2011, Adv. No. 10-3023DM) [2011 WL 1539796, at *5]). The Bankruptcy Court, relying on Heller's governing documents and following established California law, also held that the Shareholders of Heller had the fiduciary duties of partners in the Heller partnership. ER 108-11.

Extensive discovery then was completed. The discovery established that each of the Law Firm Respondents received millions of dollars in gross legal fees from completing Heller's unfinished business matters through December of 2011 alone. ER 384-420; 421; 427.[6] Moreover, the Law Firm Respondents received substantial fees resulting in millions of dollars more in ***new business*** from the Heller clients brought over to it by the Heller Shareholders.[7] The Law Firm Respondents benefited from gaining many new clients, including

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[6] See also, for Respondent Jones Day ("JD"), JD ER at 287-289; 291; 294-296; 323-325, in Ninth Circuit Court of Appeals Case No. 14-16315; for Respondent Orrick, Herrington & Sutcliffe LLP ("Orrick"), Orrick ER 413-414; 415-424; 425-429; 430-431, in Ninth Circuit Court of Appeals Case No. 14-16318; for Respondent Foley & Lardner LLP ("FL"), FL ER at ER 350-55; 360-61; 362; 364; 365, in Ninth Circuit Court of Appeals Case No. 14-16317. The actual information cited to is in the Excerpts of Record that were filed under seal in each of the cases and thus is not provided in this brief.

[7] Heller has not contended that it has an interest in new business under the Unfinished Business Rule.

potentially lucrative long-term corporate client relationships. See ER 384-420; 421-82. 297-310; 311-315; 316-320.

The Law Firm Respondents obviously hoped for a substantial profit from bringing over lateral shareholders. ER 424-26.

The Law Firm Respondents enjoyed high profit margin percentages on the gross legal fees it received during the relevant time period.[8] The total fees received from Heller's unfinished business matters were just a small percentage of each of the Law Firm Respondents' total revenue. Returning some of the substantial profits received from Heller's unfinished business, while deducting proper overhead costs to complete the business and reasonable compensation, will help diminish the losses for Heller's creditors while only nominally affecting the Law Firm Respondents overall profitability.

By the fall of 2011, Heller was able to settle its *Jewel* claims with most of the law firm defendants. Heller collected in excess of $8 million for the creditors of Heller. (See *In re Heller Ehrman LLP,* Case No. 08-32514 (Bankruptcy Court, Northern District of California), Docket No. 2640, at page 2 [Motion to Approve Settlement With Sheppard Mullin Richter & Hampton LLP and Goodwin Procter LLP]; see also Docket No. 2581, at page 2 [Motion to Approve Settlement With Arnold & Porter LLP, *et al.*].)

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[8] Jones Day enjoyed a 44% profit margin on the gross legal fees it received during the relevant time period. JD ER 217-222. Orrick enjoyed a 32% profit margin on the gross legal fees it received during the relevant time period. Orrick ER 332-337, 434-435. DWT and FL also enjoyed high profit margins on the gross legal fees it received during the relevant time period. DWT ER 428; FL ER 366, 356-57.

Heller II (MSJ): In June 2012, in the four remaining adversary proceedings cases subject to these appeals, Heller filed motions for summary adjudication as to all liability issues on the constructive fraudulent transfer claim. ER 50. The Bankruptcy Court issued a Memorandum Decision granting Heller's motions finding, as a matter of undisputed fact, Heller established the three elements to prove a constructive fraudulent transfer and the absence of an essential element of the law firms' "safe harbor" defense to such actions.[9] See ER 48-86, available at (*Heller Ehrman LLP v. Jones Day (In re Heller Ehrman LLP)*, (Bankr. N.D.Cal., Mar. 11, 2013, Adv. No. 10-3221DM) [2013 WL 951706.])

Heller III (Damages): In the summer of 2013, Heller and the law firms filed cross-motions for summary judgment related to damages, namely the amount of profits derived from the gross unfinished business legal fees collected by the law firms. On January 28, 2014, the Bankruptcy Court denied the parties' summary judgment motions, holding that questions of fact exist as to the amount of "reasonable compensation" (Cal. Corp. Code § 16401(h)), and the necessary overhead expenses (per *Jewel*) to be deducted by from the gross legal fees received. ER 18-41, available at (*Heller Ehrman LLP v. Jones Day (In re Heller Ehrman LLP)*, (Bankr. N.D.Cal., Jan. 28, 2014, Adv. No. 10-3221DM) [2014 WL

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9 There is an affirmative defense available to defendants in constructive fraudulent transfer actions who can establish that the transfer was received in good faith, without knowledge of the voidability of the transfer, and for value. (See 11 U.S.C. §550(b)).

323068.])[10] The Bankruptcy Court then certified the four remaining cases were ready for jury and bench trials.

Heller IV (District Court): After the District Court entered an order withdrawing the reference, it decided to conduct a "de novo review" of the summary adjudication decision. The parties were ordered to submit simultaneous briefs addressing "the Bankruptcy Court's determination of the *Jewel* issue." ER 316-320. On June 5, 2014, the District Court held a consolidated hearing on "the *Jewel* issue." Six days later it issued a summary judgment decision[11] that, under California law, Heller had no property interest in hourly fee matters pending at the time of the firm's dissolution. See ER 3-15, published at (*Heller Ehrman LLP v. Davis, Wright, Tremaine, LLP (In re Heller Ehrman LLP)* (Bankr. N.D.Cal., June 11, 2014, No. C14-01236 CRB) [2014 WL 2609743.])

Heller V (Ninth Circuit): After full briefing and argument, the Ninth Circuit issued its order certifying a question of state law to this Court. (*Heller Ehrman LLP v. Davis Wright & Tremaine LLP (In re Heller Ehrman LLP)* (2016) 830 F.3d 964.) The Ninth Circuit reviewed the development of the Unfinished Business Rule in California. (*Id.* at 966-68.) The Ninth Circuit then considered the impact of California's passage of RUPA and its provision allowing for "reasonable compensation" for partners' services rendered in winding up a dissolving partnership. (*Id.* at 968-69.) The Ninth Circuit found

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[10] The bankruptcy court had previously discussed the calculation of damages in *Brobeck*, (408 B.R. at 326-27 & n. 4.)

[11] Identical memorandum decisions were issued in each case. ER 3.

that no published California case had considered if the passage of RUPA changed the Unfinished Business Rule. (*Id.* at 969.) It certified to this Court the question regarding a law firm's interest in hourly fee matters pending at the time of a law firm's dissolution, since the state law rights of a dissolved firm to an accounting for the profits from the unfinished hourly business matters will determine if there is a property interest that can be the subject of a fraudulent transfer. (*Id.*)

III. THE RIGHTS, DUTIES AND PROPERTY OF A CALIFORNIA PARTNERSHIP AND ITS PARTNERS IN DISSOLUTION AND WINDING UP OF THE PARTNERSHIP ARE GOVERNED BY CORPORATIONS CODE §§ 16100-16962.

Answering the question before this Court turns on the construction of California's Uniform Partnership Act, as revised (and renumbered) by a set of amendments that became effective in 1999, known as the California Uniform Partnership Act of 1994 ("RUPA"). (Cal. Corp. Code §§ 16100-16962.)[12] Many principles in the UPA and RUPA derive from the longstanding common law of partnership. To the extent the UPA and RUPA are consistent with existing common law at the date of adoption or amendment, the UPA and RUPA are construed to incorporate common law principles, not to

[12] From 1929 to 1949 the Uniform Partnership Act was codified in the California Civil Code. From 1949 to 1996, the Uniform Partnership Act was codified at Corporations Code §§ 15001 et seq. RUPA (Corporations Code §§ 16100-16962) now governs all California general partnerships, including those formed before RUPA's January 1, 1997 effective date. (Cal. Corp. Code § 16111.)

supplant them. (See *Enea v. Superior Court* (2005) 132 Cal.App.4th 1559, 1564–65.)

Under the UPA and RUPA, "a partnership continues after dissolution." (Cal. Corp. Code § 16802(a).) The partnership is not terminated until the winding up of its business is completed. The partners of a firm in dissolution continue as partners owing fiduciary duties to the partnership in dissolution until all of its business is completed and the partnership is wound up completely. (See Cal. Corp. Code §16802(a); see also *In re Wilshire Courtyard* (9th Cir. 2013) 729 F.3d 1279, 1293 n.12 [former partners of partnership remained partners under Cal. Corp. Code §16802 because the partnership had not yet wound up its business]; Alan R. Bromberg & Larry E. Ribstein, *Bromberg and Ribstein on Partnership* § 7.01(b) at 7:9-7:12 (2011).)

The object of a partnership winding up process is to ensure that the partnership "discharge[s] its obligations to creditors" (and only after that distributes assets to partners). (Cal. Corp. Code § 16807.) In pursuit of this objective, each partner of a dissolving partnership is required "[t]o account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property or information, including the appropriation of a partnership opportunity." (Cal. Corp. Code § 16404(b)(1).)

The partnership has a cause of action against a partner who breaches this duty or any other duty connected with winding up. (Cal. Corp. Code § 16405.)

It is undisputed that the vote of Heller's partners on September 26, 2008, was a vote to dissolve the Heller law firm. The vote put Heller into a statutory winding up mode under section 16802(a). Heller's financial interest in business that was acquired by the firm, including business that was not complete at dissolution, is codified in Corporations Code section 16404(b)(1), reflecting case law that extends back to many years before the UPA and RUPA were adopted, which incorporated and solidified this Unfinished Business Rule.

IV. THE PRIMARY GOAL OF WINDING UP IS FOR A PARTNERSHIP TO "DISCHARGE ITS OBLIGATIONS TO CREDITORS" USING ALL OF THE PARTNERSHIP'S AVAILABLE ASSETS.

Corporations Code section 16807(a) mandates that a partnership winding up is to be completed as follows:

> **16807.** (a) In winding up a partnership's business, the assets of the partnership, including the contributions of the partners required by this section, shall be applied to discharge its obligations to creditors, including, to the extent permitted by law, partners who are creditors. Any surplus shall be applied to pay in cash the net amount distributable to partners in accordance with their right to distributions under subdivision (b).

(Cal. Corps. Code § 16807(a).)[13]

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[13] Subsections (b)-(f) of Corporations Code § 16807 are omitted as less directly relevant to this analysis. Those subsections generally provide for how any remaining assets are distributed among partners, after creditors are paid, and partners' obligations if there are net liabilities.

In carrying-out the mandate of Corporations Code section 16807, partners of a partnership-in-dissolution are subject to fiduciary duties under Corporations Code § 16404, which provides:

> **16404.** (a) The fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care set forth in subdivisions (b) and (c).
>
> (b) A partner's duty of loyalty to the partnership and the other partners includes all of the following:
>
> > (1) To account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property or information, including the appropriation of a partnership opportunity.
> >
> > (2) To refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership.
> >
> > (3) To refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.
>
> (c) A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.

> (d) A partner shall discharge the duties to the partnership and the other partners under this chapter or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing.
>
> (e) A partner does not violate a duty or obligation under this chapter or under the partnership agreement merely because the partner's conduct furthers the partner's own interest.
>
> (f) A partner may lend money to and transact other business with the partnership, and as to each loan or transaction, the rights and obligations of the partner regarding performance or enforcement are the same as those of a person who is not a partner, subject to other applicable law.
>
> (g) This section applies to a person winding up the partnership business as the personal or legal representative of the last surviving partner as if the person were a partner.

(Cal. Corp. Code § 16404.)

Corporations Code section 16404(b)(1), concerning a partner's duty to account for "any property, profit or benefit" during winding up, was codified in the original 1929 UPA as California Civil Code § 2415, then moved in 1949 to Corporations Code § 15021, then into Corporations Code § 16404(b)(1). Former Corporations Code section 15021(1) provided: "Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property."

The scope of "property," "profit", "benefit" and "opportunities" covered by Corporations Code section 16404(b)(1) is purposefully broad and comprehensive statutory language. The term "property" is defined for all purposes in UPA/RUPA, including section 16404(b)(1), as "all property, real, personal, or mixed, tangible or intangible, or any interest therein." (Cal. Corp. Code § 16101(15).) "Property acquired by a partnership is property of the partnership and not of the partners individually." (Cal. Corp. Code § 16203; see also Cal. Corp. Code § 16204) ["Property is partnership property if acquired in the name of...[t]he partnership"].) Taken as a whole, the partnership assets and financial interests that are within the scope of a partner's fiduciary duty to account to the partnership during winding up are comprehensive. (*Copley Press, Inc. v. Superior Court* (2006) 39 Cal.4th 1272, 1291–92) [a narrow or restricted meaning of statutory language will not be adopted if the purpose of the language was broad].)

While Corporations Code section 16404 is the first statutory provision to enumerate expressly fiduciary duties of general partners, it was intended to reflect existing case law. The Senate Floor Analysis for RUPA stated that "the new fiduciary duty section makes no substantive changes from prior law." (Senate Rules Committee, Senate Floor Analysis, AB 583 (Aug. 23, 1996), at 6; *Hutnick v. U.S. Fidelity & Guaranty Co.* (1988) 47 Cal.3d 456, 465 n. 7 [the materials presented in explanation of a statute provide some indication of how the measure was understood by those who voted to enact it]; *Regency Outdoor Advert., Inc. v. City of Los Angeles* (2006) 39 Cal.4th 507, 526) ["it is not to be presumed that the legislature in the enactment of

statutes intends to overthrow long-established principles of law unless such intention is made clearly to appear either by express declaration or by necessary implication"].)

V. THE "UNFINISHED BUSINESS RULE" IS A DIRECT APPLICATION OF THE LONGSTANDING PARTNERSHIP WINDING UP PRINCIPLES EMBODIED IN THE UPA/RUPA.

A. UPA/RUPA Incorporates the Extraordinarily Long-Established Unfinished Business Rule.

The Unfinished Business Rule recognizes that partners have long had a fiduciary duty to account for the profits generated from partnership business. (See *Gorman v. Russell* (1860) 14 Cal. 531, 539) [recognizing fiduciary duties partners owe to each other].) The Unfinished Business Rule applies to all partners at the time of dissolution, whether they remain behind to wind up the firm's business or leave their former firm and complete the business elsewhere. As the United States Supreme Court put it over a century ago:

> Having jointly undertaken the business intrusted to the partnership, all the parties were under the obligation to conduct it to the end. This duty they owed to the clients and to each other. And as to the unfinished business remaining with the firm on [the date of dissolution], the duty continued.

(*Denver v. Roane* (1878) 99 U.S. 355, 358.) In the two decades after *Denver*, the California Supreme Court twice affirmed the unfinished business doctrine in the context of a dissolved law partnership. (See *Osment v. McElrath* (1886) 68 Cal. 466; *Little v. Caldwell* (1894) 101

Cal. 553, 560 ["[T]he survivor [partner] is bound to complete the unfinished contract for the benefit of the partnership."].)

The *Osment* case involved a two-person law partnership. Upon dissolution, one partner remained in California to complete the firm's cases. The other partner moved to Tennessee to practice law. (68 Cal. at 467.) For the next two years, the California partner completed the firm's unfinished business, which consisted of both contingent fee and other fee payments. (*Id.*) The Tennessee partner returned to California seven years after the dissolution. He brought an accounting action to recover one-half of the fees collected on the partnership's unfinished business. (*Id.* at 467-68). This Court agreed with the Tennessee partner, holding that the unfinished business doctrine "is the rule of commercial partnerships" and "[w]e are satisfied that the [Tennessee partner] was entitled to share in the fees collected for the unfinished business." (*Id.* at 469-70 citing *Denver v. Roane* (1878) 99 U.S. 359.)[14]

Eight years later, the Court applied the Unfinished Business Rule again in *Little v. Caldwell.* The case was an accounting suit brought by the widow of a deceased law firm partner seeking fees recovered by the surviving partner in a contingency case. (101 Cal. at 557-58.) The surviving partner tried to pay $100 to the widow (for her interest in the pending case) while executing a new retention agreement with the client. (*Id.*) The surviving partner later collected $12,000 in fees, but refused to account for any more than the $100

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[14] The *Osment* Court also noted that the partners could have decided to "divide the labor and the fees [collected on the unfinished business] as they pleased." (68 Cal. at 469.)

payment. (*Id.* at 558.) The Court held that "the survivor [partner] is bound to complete the unfinished contract for the benefit of the partnership," noting the partner "occupies the position of a trustee" in relation to unsettled and unfinished business of the firm. (*Id.* at 560.)

Little further explained the importance of the duty to account:

> This rule is particularly applicable in the settlement of the partnership accounts of attorneys at law, when the firm has been dissolved by the death of one member, leaving ***contracts not fully performed, often constituting a large part of the assets of the partnership***, and which it is the duty of the survivor as far as possible to complete and preserve for the benefit of the firm.

(*Id.* at 561 emphasis added). The Court had "no difficulty in reaching the conclusion that the [widow of the deceased partner] is entitled to recover [one-half of the contingent fee provided in the original contract]." (*Id.*)

1. The California Legislature Codified the Unfinished Business Rule, Which Has Been Recognized by Many Different California Courts.

In enacting Section 21 of the UPA in 1929 (California Civil Code § 2415),[15] the Legislature codified the common law Unfinished Business Rule, with one limited exception. The UPA codified the fiduciary duty of partners to each other to "account to the partnership for any benefit, and hold for him all profits derived by him" from conducting partnership business. (Cal. Corp. Code § 15201(1)

[15] In 1949 the provision was placed in the Corporations Code, but not otherwise changed. (Cal. Corporations Code § 15021(1).)

(1998).) The UPA further provided that "[n]o partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his or her services in winding up the partnership business." (Cal. Civil Code § 15801(f) [originally Cal. Civ. Code § 2412(f)].) In *Jacobson v. Wilkhom* (1946) 29 Cal.2d 24, 29, this Court noted that the UPA followed the rule outlined in *Little*. This Court acknowledged the limited exception to the "no compensation" rule that otherwise applied under the UPA, when it "interpreted this language [(in section 2412(f))] to mean that, after the *death of a partner*, the *surviving partner* was entitled to reasonable compensation 'based on the time, labor, and skill expended' in winding up pending matters." (*In re Heller Ehrman LLP,* 830 F.3d at 967 [emphasis added]; *Wilkhom* 29 Cal.2d at 32.)

Subsequently, other California courts also have uniformly recognized a partner's duty to account for the profits from unfinished business that applies to a partner completing the unfinished business of a dissolving partnership, which carried forward from common law into the partnership acts. In 1983, the Court of Appeal considered a dispute arising out of the dissolution of a 17-partner law firm ("RM&S"), which represented a major client ("Rectifier") in an antitrust case paid on a flat fee and contingent fee basis. (*Rosenfeld, Meyer & Susman v. Cohen* (1983) 146 Cal.App.3d 200, 209 & 210.) ("*RMS I*"). Two partners ("C&R") received full partnership draws for five years, even though the Rectifier matter produced "virtually no income" for RM&S during that time. (*Id.*) As the Rectifier matter moved close to trial, C&R notified RM&S that they planned to

withdraw from the firm. (*Id.* at 210.) This resulted in the dissolution of RM&S. (*Id.* at 216.) Rectifier then discharged RM&S and hired C&R to complete the antitrust action. (*Id.* at 210.) The RM&S remaining partners brought several claims against C&R. The trial court dismissed them, "reasoning that Rectifier's [post-dissolution] discharge of RM&S precluded any liability." (*Id.* at 217.) *RMS I* reversed. It held that C&R owed a fiduciary duty to account under California's UPA and "it is clear . . . that the RM&S-Rectifier agreement was unfinished business of RM&S." (*Id.*) *RMS I* also noted that "[t]he *Little v. Caldwell* opinions and other unfinished business cases strike a reasonable balance between a partner's right to pursue his own business after dissolution of a partnership, and his duty of loyalty to his ex-copartners." (*Id.* at 219-20.)

Following *RMS I* is the most widely cited unfinished business decision in California, *Jewel v. Boxer*, a case which stemmed from the dissolution of the Jewel, Boxer, and Elkind firm. (*Jewel v. Boxer* (1984) 156 Cal.App.3d 171, 174.) The four former partners formed two new firms, Jewel and Leary, and Boxer and Elkind. (*Id.* at 175.) After dissolution, each partner sent letters to the clients whose cases they handled at the old firm, informing the client of the dissolution and enclosing a substitution of attorney form. (*Id.*) There was no partnership agreement concerning the allocation of future fees earned on active cases. (*Id.*) Jewel and Leary sued Boxer and Elkind asserting that the fees earned on the dissolved firm's unfinished cases were assets of the dissolved partnership and that they were therefore entitled to an accounting. (*Id.*)

The trial court allocated the post-dissolution fees on a *quantum meruit* basis. (*Id.* at 175.) The Court of Appeal reversed, determining that the UPA governed and provided the proper formula. (*Id.* at 176.) It held that what controlled was the UPA's express provision that "[n]o partner (except a surviving partner) is entitled to extra compensation for services rendered in completing the unfinished business. *Cal. Corp. Code § 15018 subd. (f).*" (*Id.* footnote omitted.) "Thus, absent a contrary agreement, any income generated through the winding up of unfinished business is allocated to the former partners according to their respective interests in the partnership."[16] (*Id.*) The Court of Appeal rejected both the trial court's reliance on a Texas intermediate court decision and this Court's decision in *Fracasse v. Brent,* which it correctly held was not relevant to determining "whether business is unfinished business of the dissolved partnership." (*Id* at 178.)[17]

Jewel refused to create any exception to the UPA for lawyers, reasoning that "[t]he definition of 'business' [in California's UPA section 15002] as including 'every trade, occupation, or profession'...

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[16] California's RUPA provides that, "[i]n winding up a partnership's business, the assets of the partnership, including the contributions of the partners required by this section, shall be [first] applied to discharge its obligations to creditors," before any surplus is distributed to the partners or any settlement of partnership accounts. (Cal. Corp. Code § 16807(a), (b).)

[17] In *Fracasse v. Brent* (1972) 3 Cal.3d 784, 786, this Court addressed the rights of an attorney for legal fees as against his client. As the *Jewel* court noted, relying in part on prior Court of Appeal decisions, the rights between partners with respect to income from unfinished business and the rights of an attorney against her client are distinct. (156 Cal.App.3d at 177-78.)

***precludes an exception for law partnerships.*" (*Id.* at 177) (citation omitted, emphasis added).[18] In addition, *Jewel* rejected the trial court's ruling that application of the unfinished business rule interfered with the client's right to an attorney of their choice. (*Id.* at 178.) The Court of Appeal held that the client's right to an attorney of one's choice and the rights and duties of partners regarding unfinished business do not conflict because once the client has paid fees to an attorney the client has no interest in the allocation of those fees. (*Id.*)

In its opinion, *Jewel* noted that its holding was based upon fiduciary principles codified in the California statute, but also was equitable. The opinion noted that "each former partner has a duty to wind up and complete the unfinished business of the partnership." (*Id.* at 179.) To the extent the default Unfinished Business Rule imposes a burden on the partners, it is the consequence of the partnership's own failure to provide for the allocation of post-dissolution fees in the law firm's partnership agreement. (*Id.* at 180.) Finally, *Jewel* addressed the "sound policy reasons" supporting its holding, particularly that (1) it prevents partners from competing for the most lucrative client matters during the life of the partnership so that they may retain those matters in a dissolution and (2) it "discourages former partners from scrambling to take physical possession of files and seeking personal gain by soliciting a firm's existing clients upon dissolution." (*Id.* at 179.)

After *Jewel*, in *Fox v. Abrams* (1985) 163 Cal.App.3d 610, 612-13, the Court of Appeal dealt with the "bitter breakup" of a four-

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[18] Current Section 16101(1) of California's RUPA adopts the same definition of "business." (Cal. Corp. Code §16101(1).)

lawyer firm and disputes about the allocation of fees on certain contingency cases. Two sets of lawyers filed numerous claims asserting rights to "the fees subsequently received for the cases which were in process on the dates of the [lawyers'] resignations." (*Id.* at 612.) The trial court, relying on *Fracasse v. Brent,* entered a judgment that one lawyer (Adams) "was entitled only to quantum meruit for the reasonable value of [pre-resignation services]." (*Id.*) On appeal, however, *Fox* reversed the trial court's judgment. It explained: "[t]he *Fracasse v. Brent* test on which [the trial court based its quantum meruit ruling]... has nothing to do with how the fee should be allocated among the lawyers who formerly practiced together." (*Id.* at 613.) *Fox* examined *RMS I* and *Jewel* and affirmed the principles underlying the Unfinished Business Rule, noting "[t]he law should simply recognize that the lawyers once practiced together and are now practicing separately on the same cases as before." (*Id.* at 616.) In addition, *Fox* reasoned that its ruling would not impede client choice, finding that "[t]he subsequent executions of substitutions of attorney did not alter the character of the cases as unfinished business of the former firm." (*Id.* at 613-14.)

The *RMS I* litigation led to another appeal in *Rosenfeld, Meyer & Susman v. Cohen* (1987) 191 Cal.App.3d 1035 ("*RMS II*"). The court reaffirmed the principles in California's UPA and *Jewel*, while holding that a partner collecting the fee has the burden of establishing offsets of expenses chargeable to the unfinished business. (*Id.* at 1051-53 & 1061.)

In *Rothman v. Dolin* (1993) 20 Cal.App.4th 755, 759, the trial court applied the duty to account to hourly cases in a dissolution of a

two-person law firm. Relying on *Jewel* and *Fox*, it ruled that "all pending cases" at dissolution were unfinished business of the firm. (*Id.* at 757.) *Rothman* affirmed, concluding that the unfinished business doctrine "appl[ies] with equal force to both contingency and hourly rate cases." (*Id.* at 758.) One of the reasons that *Rothman* refused to make a distinction between hourly or contingent fee cases is that it "would lead to the prospect of attorneys shunning contingency fee cases in anticipation of a possible dissolution of the law firm, and scrambling to get the hourly rate cases." (*Id.*) *Rothman* then expanded on its holding, stating: "[t]hat one matter is to be compensated at an hourly rate and another on a contingency basis is of no consequence in determining whether a matter is unfinished business." (*Id.* at 759.)

Rothman stands on solid ground with this Court's decision in *Osment*. In *Osment*, this Court affirmed the partners' duty to account where the dissolved firm "had several cases in the courts, in some of which the fees were, and in others were not, contingent upon their success." (68 Cal. at 467.) The rule is the same in most other jurisdictions that have considered the issue.[19]

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[19] See *Robinson v. Nussbaum* (D.D.C. 1997) 11 F.Supp.2d 1, 4-5) (confirming that D.C.'s UPA "requires that former partners share ***all*** profits earned from completing client matters that were pending at the time of dissolution. . . . [H]ow the firm's clients were billed, either at an hourly rate or on a contingency fee, does not change the status of their work as partnership property"); see also, e.g., *Labrum*, (Bankr. E.D.Pa. 1998) 227 B.R. 391, 408. ("[E]very other court confronted with this issue . . . has held that pending cases, regardless of whether they are hourly-fee cases or contingent-fee matters, are unfinished business requiring winding up after dissolution, and are therefore

2. **Principles in this Court's Decision in *Howard v. Babcock* Support the Unfinished Business Rule.**

In *Howard v. Babcock* (1993) 6 Cal.4th 409, 424 n.8, this Court cited *Jewel* and *RMS I* approvingly. Moreover, *Howard* outlined three key points: (1) pending matters are assets of a law firm; (2) imposing a reasonable toll or economic consequence on departing partners helps stabilize partnerships and is not an unreasonable restriction of lawyer mobility; and (3) these results do not violate California's legal ethics rules.

First, in discussing how the partners eventually split into two firms, *Howard* explained that "[t]he assets of the original [law] firm . . . included [1] the capital of the firm, . . . [2] the accounts receivable, and . . . [3] the unfinished business, that is, open files that required additional work that would be billed in the future." (*Id.* at 413.) In this respect, both the appellate court and the Supreme Court in *Howard* cited *Jewel* approvingly. (*Id.* at 424 n.8.)

Second, *Howard* approved a restrictive covenant in the partnership agreement even though it "attaches an economic consequence" to a partner leaving a law firm. (6 Cal.App.4th at 419.) *Howard* found that this "reasonable cost" assessed against the departing partner "[did] not restrict the practice of law." (*Id.*) The primary justification in *Howard* for the restriction was that "the remaining partners remain able to ***preserve the stability*** of the law

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assets of the partnership subject to post-dissolution distribution."); *Beckman v. Farmer* (D.C. 1990) 579 A.2d 618, 639) ("[A]ll work performed on partnership business unfinished at the date of dissolution . . . was done for the benefit of the dissolved partnership."); but see *In re Thelen LLP,* (2014) 24 N.Y.3d 16, 22.)

firm" and to support the partnership's debts. (*Id.* at 419-20 emphasis added); (see also *Haight,* 234 Cal.App.3d at 969-70) (approving a restrictive covenant in a partnership agreement, noting "the remaining partners remain able to preserve the stability of the law firm").

This Court in *Howard* rejected the lower court's attempt to treat a law partnership any differently under the California statute governing agreements not to compete, "conclud[ing] that the statute applies to partners in law firms." (*Id.* at 418.) The *Howard* Court largely adopted the reasoning in *Haight, Brown & Bonesteel v. Superior Court,* which also approved a restrictive covenant in a law partnership agreement and refused to craft a judicially-created exception. ((1991) 234 Cal.App.3d 963, 971) ["[W]e find no reason to treat attorneys any differently from professionals such as physicians or certified public accountants" for purposes of California's statute governing non-compete provisions].) The *Howard* Court noted that "[n]othing in [the statute's] language conveys an exception to its terms for lawyers," and the statute's historical background did not create "an unspoken exception." (6 Cal. 4th at 417.)

This Court throughout *Howard* balanced the interest of clients in having the attorney of choice and "the interest of law firms in a stable business environment." (*Id.* at 421-25.)[20] *Howard* emphasized

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[20] The *Howard* Court noted several times the importance of its ruling in helping to stabilize law firms. (6 Cal.4th at 420) (expressing concern that the "traditional view of the law firm as a stable institution with an assured future is now challenged by an awareness that even the largest and most prestigious firms are fragile economic units"); *id.* (noting "[i]n earlier times, [the firm's capital] investment [to develop clients and attorneys] was fairly secure, because the continued loyalty

how a partner's departure "can place a tremendous strain on the firm" due to increased costs or debt obligations, (see *id.* at 421), and for those reasons, "partnerships may be less willing to invest monies necessary to provide the [capital] to serve a client well if a partner could both leave the firm free of the mutually incurred liability, and also take the future income of the firm." (*Id.* at 425.)[21] The Unfinished Business Rule also helps stabilize law firms and ensures that all partners must account for the profits from all pending matters of the firm—unless the partners contract for a different result.

Third, *Howard* rejected the argument made by the withdrawing partners (and the State Bar of California, as amicus curiae) that Rule 1-500 of the Rules of Professional Conduct overrides the California statute. (*Id.* at 429.) The withdrawing partners' primary argument was that the non-compete provisions would inhibit "client choice of counsel . . . [or] attorneys of the right to practice their profession." (*Id.* at 425.) The Court disagreed, noting that it was "confident" that its ruling "will have no deleterious effect on the current ability of clients to retain loyal, competent counsel of their choice." (*Id.* at 420.)

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of partners and associates was assumed"); (*id.* at 421) (explaining a dissociating partner's departure "can place a tremendous strain on the firm" because "the expenses attributable to the remaining partners may increase as withdrawing partners seek to escape liability for mutually incurred debt").

[21] See also *In re Thelen LLP* (2d Cir. 2013) 736 F.3d 213, 222 n.11) (quoting Mark Harris, *Why More Law Firms Will Go the Way of Dewey & LeBoeuf*, Forbes, May 8, 2012) ["The portability of the partner's 'book' has weakened the bonds that hold firms together and threatens the identity of the law firm as we know it."]).

3. California Courts Continued to Apply the Unfinished Business Rule as RUPA Was Being Implemented by the California Legislature.

A version of the RUPA was "initially introduced in 1994 as AB 2612." (AB 583, Assembly Bill Analysis, Assembly Committee on the Judiciary, (January 12, 1996), at 1.) During the period in which the RUPA was being considered, and after the RUPA was passed in 1996, a number of California Courts applied the Unfinished Business Rule to dissolving law partnerships.

In *Grossman v. Davis* (1994) 28 Cal.App.4th 1833, 1835-36, the court faced a dispute related to a two-lawyer partnership where Davis and Grossman represented a plaintiff in a personal injury case ("the *Janes I* action") that eventually settled and then led to a bad faith claim against an insurer ("the *Janes II* action"). After the partnership's dissolution, Davis pursued the *Janes II* action and recovered over $120,000 in attorney's fees. (*Id.* at 1836.) Grossman brought claims against Davis, arguing that "the fees from *Janes II* were generated through the winding up of the unfinished business of the partnership." *Id.* The court in *Grossman* agreed that, "The *Janes II* action was a continuation by other means of the dissolved partnership's unfinished business in *Janes I*." (*Id.* at 1837.)

In 1995, the dispute in the case of *Dickson, Carlson & Campillo v. Pole* (2000) 83 Cal.App.4th 436, started. Brobeck hired from the Dickson firm two senior partners—who took a "major client" with them. This led to Dickson, Carlson & Campillo (and eight of its partners) filing claims for a partnership accounting of hourly fee profits earned on the hourly fee cases. (*Id.* at 440.) The Dickson's

Firm's major client was Baxter Healthcare, a defendant in many product liability actions. (*Id.*) The trial court in *Dickson* denied all relief sought by the Dickson Firm on its accounting claims reasoning that it failed to "do equity" during the dissolution by refusing to continue working for Baxter. (*Id.* at 440-443.) The Court of Appeal reversed, holding that the "do equity" defense was not an absolute bar to the accounting action. (*Id.* at 448.) It also approved the partnership principles outlined in a string of California cases. (*Id.* at 445.)

In *Anderson, McPharlin & Connors v. Yee* (2005) 135 Cal.App.4th 129, 131, the Court of Appeals did not address the Unfinished Business Rule directly, but did address related issues. *Anderson* involved a law partner ("Yee") who joined a large law firm ("AMC") in 2001 with the understanding, as stated in a partnership agreement, that "the firm had invested a substantial amount of money in generating business and that the firm would lose money if he left and took clients with him." The firm's partnership agreement also required Yee to remit back 25% of the fees for a period of two years—if he left the firm with "open files." (*Id.* at 131-32.) Yee then left AMC and joined two other firms in the next two years. (*Id.* at 132.) AMC brought contract and accounting claims against Yee and won at trial. *Id.* On appeal, Yee argued that the partnership agreement was unenforceable because it resulted in impermissible fee-splitting. (*Id.*) *Anderson* rejected the argument. The court held that the sharing of fees would not impact client choice or legal ethics rules because "[o]nce the client's fee is paid to an attorney, it is of no concern to the client how that fee is allocated among the attorney and his or her former partners." (*Id.* at 133 [citing *Jewel* and *RMS I*].)

B. RUPA's Provisions Adopt the Unfinished Business Rule, Modifying the Rule only to Provide that Partners Completing the Dissolving Firm's Business Are Entitled to Reasonable Compensation for Services Provided.

When California adopted RUPA in 1996 it included Corporations Code section 16404(b)(1), setting forth a partner's duty to account for and hold as trustee any profit derived by the partner in winding up the partnership's business, as discussed above. RUPA modified the rule, however, by providing in section 16401(h) that partners are entitled to "reasonable compensation for services rendered in winding up the business of the partnership." (Cal. Corp. Code § 16401(h).)

Other than the provision allowing for "reasonable compensation" to partners for completing a dissolving firm's business, RUPA maintained the established Unfinished Business Rule. (See, e.g., 9 B. Witkin, *Summary of California Law, Partnerships*, § 30 at 604 (10th ed. 2005)) ["Although the [RUPA] treats the topic of fiduciary duties extensively, the Partnerships Committee of the State Bar, in reviewing California cases dealing with the fiduciary duties of partners, concluded that none would have been decided differently under the [RUPA]."]; see also Donald J. Weidner, *Cadwalader, RUPA, and Fiduciary Duty*, (1997) 54 Wash. & Lee L. Rev. 877, 913 [discussing fiduciary duties under RUPA and noting "the drafters did not intend to change current law [in UPA]")] (*id.* at 913 n.177 ["No change from the current law [in UPA] is intended." (quoting RUPA § 603, cmt. 2)].) Indeed, this Court has long discouraged the implied abrogation of existing law. (See, e.g.,

California Ass'n of Health Facilities v. Dep't of Health Servs. (1997) 16 Cal.4th 284, 297.) ["There is a presumption that a statute does not, by implication, repeal the common law."].)

There is no support in the language of RUPA, or the plain intent of its extremely broad definition of what assets are available to a winding up partnership, for concluding that the Legislature abrogated the longstanding rule that unfinished partnership business is an asset of the partnership.

C. The Unfinished Business Rule Is Essential to Secure Payment to Creditors with All Available Partnership Assets, Which is the Core Objective of the Winding Up Process Under the UPA/RUPA.

The first priority for distributing assets in the winding up of California partnerships is to apply the assets to discharging the partnership's obligations to creditors. (Cal. Corp. Code § 16807(a).) The Unfinished Business Rule, particularly in the law partnership context, is critical to marshalling the available assets for the benefit of the partnership's creditors. In Heller's case, as is the case with most law firms on dissolution, these creditors include employees (here hundreds of employees who were terminated with very little notice in what was alleged in a class action by Heller's former employees to be a violation of the Worker's Adjustment and Retraining Notification Act (WARN Act)); the associate lawyers, many of whom were also terminated with very little notice; retired shareholders who were owed pension obligations; court reporters, litigation support firms, and other trade creditors of Heller who were owed millions.

Heller, like most law firms, had very little by way of hard assets available for distribution to its creditors upon its dissolution. Heller's ability to collect the profits from the hourly unfinished business matters, after accounting for reasonable compensation and overhead attributable to completing those matters, had a huge impact on the partnership's ability to pay back its creditors. Even though Heller's ability to realize the full amount of the share of its profits collected from the completion of its hourly unfinished business matters was greatly hampered by the *Jewel* Waiver, which raised issues as to Heller's entitlement to an accounting for such profits that would not have otherwise existed, Heller was able to recover over $8 million in settlements from the law firms with which it was able to settle. See *supra* at 8. The recoveries to date on the unfinished business claims were critical to Heller's ability to thus far return to creditors 53% of the millions in dollars of losses suffered by its unsecured creditors.[22] But these creditors still have suffered great harm as they continue to be owed millions of dollars on Heller's unsecured debts. The unsecured claims when Heller's bankruptcy plan of confirmation was approved were estimated to exceed $95 million.[23]

Law firms invest substantial resources into building their practice areas, marketing, developing lawyers, and related efforts, which are necessary to attract the hourly business matters the

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[22] See *In re Heller Ehrman LLP,* Case No. 08-32514 (Bankruptcy Court, Northern District of California), Docket No. 3712, at page 6.
[23] See *In re Heller Ehrman LLP,* Case No. 08-32514 (Bankruptcy Court, Northern District of California), Docket No. 1153, at page 18 (estimating general unsecured claims to be between $95 million t0 $135 million).

partnership is able to secure. If the partnership is not able to realize the value from the profits that are earned upon the unfinished hourly matters pending on the dissolution, not only will the creditors of the partnership suffer greatly, but the partners unfortunate enough not to capture the firm's "book of business" also will bear a disproportionate brunt of the losses incurred by the partnership.

D. The Unfinished Business Rule Is Essential to Protect Partners' Expectations and Avoid Asset-Grabbing and Other Misconduct During Partnership Dissolutions.

The Unfinished Business Rule is a default rule that only applies absent a contrary agreement. (Cal. Corp. Code § 16103; *Jewel*, 156 Cal.App.3d at 179-80) ("partners are free to include in a written partnership agreement provisions for completion of unfinished business that ensure a degree of exactness and certainty unattainable by rules of general application"). California law firms have been aware of the default Unfinished Business Rule for decades and have every opportunity to structure the partnership in the manner in which they think will serve their partners best. The issue with implementing a *Jewel* Waiver in the Heller cases arises from the attempt to escape the duty to account for the profits from unfinished hourly business matters only after "the firm succumbed to insolvency." (See *Greenspan v. Brobeck Phleger & Harrison LLP (In re Brobeck, Phleger & Harrison LLP)* (Bankr.N.D.Cal. 2009) 408 B.R. 318, 325-26.)

Imposing a duty on partners to account to the firm in dissolution best comports with the basic concept of a partnership as a

joint enterprise: "an association of two or more persons to carry on as co-owners a business for profit." (Cal. Corp. Code § 16101(9).) The rule reflects the reality that client business is a valuable asset of the partnership that derives from the collective effort of the partnership as a whole, and not solely any individual partner. The default of the Unfinished Business Rule in California encourages partners who may want to alter the general rule when establishing the partnership to give advance thought as to how to vary the default rule regarding how to handle accounting for the profits on its unfinished business matters upon dissolution, while ensuring the partners and the partnership's creditors fairly receive what they expect on dissolution.

The Unfinished Business Rule helps preserve the stability of law firms, which this Court recognized in *Howard v. Babcock*, 6 Cal. 4th at 419-20, is growing increasingly fragile. Without the Unfinished Business Rule, law partnerships can face dissolution with one group of partners taking the firm's most lucrative clients with them for their sole benefit, as was the situation with the partners in the *Dickson, Carlson & Campillo* case, who took the steady work from Baxter Healthcare Corporation with them and tried to retain the profits for their own benefit. (83 Cal.App.4th 436, 441-42.) As the *Jewel* court recognized, the Unfinished Business Rule promotes orderly dissolution and curbs competitive scrambling for cases during a firm's dissolution process, which is inconsistent with the basic fiduciary duties partners owe to each other and to the partnership. (156 Cal.App.3d at 179.)

VI. THERE IS NO STATUTORY OR CASE LAW BASIS ON WHICH TO APPLY DIFFERENT, NON-STATUTORY WINDING UP PRINCIPLES TO A LAW PARTNERSHIP OR TO "LARGE LAW FIRMS."

The Law Firm Respondents have contended in these cases that the principles which pertain to dissolving California partnerships do not apply to dissolving law partnerships or "large law firms." The Legislature has created no such exception. All relevant provisions of the RUPA use the word "business" to describe winding up. (See Cal. Corp. Code §§ 16801, 16802(a), 16807, 16404.) Under Corporations Code section 16101(1), the term "business" as defined for all purposes under California general partnership law "includes every trade, occupation, and profession." (Cal. Corp. Code § 16101(1).) The argument that attorneys and law firms are not subject to the unfinished business rule was raised in this Court even before the California Legislature codified the broad application of partnership law to all partnerships – and rejected. (See *Little v. Caldwell* (1894) 101 Cal. 553, 560.) [". . . and in the case of *Denver v. Roane*, 99 U.S. 359, it was said that none of the adjudicated cases recognize any distinction in this respect between such [commercial] partnerships and those entered into between attorneys for the practice of their profession. And we know of no such distinction."]; see also *Jewel v. Boxer*, 156 Cal.App.3d at 176-79) [rejecting "law firm exception" argument under former Corporations Code § 15002, the identical predecessor to current Corporations Code § 16101(1)].)

It is not the role of a court to imply that a statute that is comprehensive on its face contains a huge exception. The exclusion of

a subject from a broad statutory provision is a matter of legislative policy, and the courts should not imply exclusions absent specific legislative direction. (*DiCampli-Mintz v. County of Santa Clara* (2012) 55 Cal.4th 983, 992.) [the court must assume the Legislature knew how to create an exception if it wished to do so]; *Rossi v. Brown* (1995) 9 Cal.4th 688, 694. [court's role is "not to read into [a statute] exceptions or qualifications that are not supported by the language"]; *In re Christian S.* (1994) 7 Cal.4th 768, 776) ["[A]n intention to legislate by implication is not to be presumed" by a court construing a statute].) The notion that lawyers can achieve a judicial exclusion from the Unfinished Business Rule that applies to all other trades, occupations and professions is inherently offensive. The California Legislature has involved itself directly and repeatedly in the consideration of how the legal profession operates and was fully capable of excluding law partnerships from any principle that applies to partnerships. The Legislature has not done so.

Similarly, the Law Firm Respondents have argued in the proceedings below that the law firms to which Heller's partners took the unfinished business should not be liable to account for the profits earned from completing the business. That issue of federal law, however, is not before this Court. The liability that Heller contends gives rise to the Law Firm Respondents' obligation to account for the unfinished business profits stems here from its contention that the law firms are liable as subsequent transferees under 11 U.S.C. section 550(a)(2) or as the entity "for whose benefit the transfer was made" pursuant to 11 U.S.C. section 550(a)(1). In this respect, Heller's claim against the law firms – as opposed to the Heller partners – turns

on questions of federal law. The California law question before this Court turns on the duties and obligations of partners to the partnership and each other under California partnership law.

The question before this Court is narrow and focuses on the statutory provisions of UPA/RUPA and basic principles of partnership law that apply between a partnership and its partners.

VII. THE NEW YORK COURT OF APPEALS DECISION IN *THELEN* IS UNPERSUASIVE AND INAPPLICABLE HERE.

Lacking support in California statutory or case law to avoid the Unfinished Business Rule or to create a lawyers' exception to the rule, the Law Firm Respondents in prior proceedings placed mistaken and heavy reliance on *In re Thelen* (2014) 24 N.Y.3d 16, a New York Court of Appeals opinion. First, of course, *Thelen* applies the law of New York, not California. Second, this Court in *Howard,* 6 Cal.4th at 421-22, specifically rejected the bright-line rule in New York that prohibits the imposition of virtually any cost to a new law firm that is associated with payments to a departing lawyer's former firm. The contrary New York law was a key factor in the *Thelen* decision. Third, New York remains a "no compensation" UPA jurisdiction, which would have made the application of the Unfinished Business Rule a harsher result than is the case in California, where the partner of the dissolved firm is entitled to reasonable compensation.

Thelen actually puts New York out of step with every virtually every other jurisdiction in the nation by essentially creating a lawyers' exception to the Unfinished Business Rule. The decision applies not only to hourly fee matters, but to profits from contingency cases as

well. In stark contrast to *Jewel*, *Thelen* limits the recovery on unfinished contingency cases to the value of the services prior to dissolution– the *quantum meruit* approach condemned by *Jewel*. *Compare* 24 N.Y.3d at 29, *with Jewel v. Boxer*, 156 Cal.App.3d at 180.

There are no valid grounds for this Court to adopt *Thelen*'s policy considerations, which elevate the financial interests of lawyers over the rights of largely non-lawyer creditors.

Thelen is counter to the law established in California and most other states. For example, the overwhelming majority of decisions in other states agree with California, and reach the same construction of the uniform partnership acts, in holding that a dissolved law partnership is entitled to recover profits from unfinished contingency cases. (See, e.g., *Hurwitz v. Padden* (Minn. App. 1998) 581 N.W.2d 359, 362-64; *Vowell & Meelheim, P.C. v. Beddow, Erben & Bowen, P.A.* (Ala. 1996) 679 So.2d 637, 640; *Gast v. Peters* (Neb. 2003) 671 N.W.2d 758, 764; *In re Labrum & Doak LLP* (Bankr. E.D.Pa. 1998) 227 B.R. 391; *Sullivan, Bodney & Hammond v. Bodney* (Kan.App. 1991) 820 P.2d 1248, 1250; *Hammes v. Frank* (Ind.App. 1991) 579 N.E.2d 1348, 1356; *Marr v. Langhoff* (Md. 1991) 589 A.2d 470, 475-76; *Gull v. Van Epps* (Wis.App. 1994) 517 N.W.2d 531, 536; *Beckman v. Farmer* (D.C. 1990) 579 A.2d 618, 636; *Ellerby v. Speizer* (Ill.App. 1985) 485 N.E.2d 413; *Resnick v. Kaplan* (Md. 1981) 434 A.2d 582; *In re Mondale & Johnson* (Mont. 1968) 437 P.2d 636; *Frates v. Nichols* (Fla.Dist.Ct.App. 1964) 167 So.2d 77; *Platt v. Henderson* (Or. 1961) 361 P.2d 73.)

Indeed, after *Thelen*, Colorado's Supreme Court joined the long list of states holding lawyers to their fiduciary duties and "applying the unfinished business rule over the quantum meruit approach" for contingency cases. (*LaFond v. Sweeney* (Colo. 2015) 343 P.3d 939, 948.) In *LaFond*, the Colorado high court affirmed the Unfinished Business Rule for law partnerships and expanded it to apply to law firms organized as LLCs. (*Id.* at 951.) The court cited the "majority of jurisdictions" that follow the rule in *Jewel* and discarded *Thelen*'s argument that "ownership" of a client matter was dispositive of anything. (*Id.* at 948.) ("[T]he relevant question here is whether the [unfinished] case is business of [the dissolved firm]; if it is, [the successor firm] must hold in trust for [the dissolved firm] any profit derived from that case.").

Notwithstanding the recent surge in interest among large law firms in changing the rules for their own financial benefit, there is no justification for this Court, or any other states, to follow the outlier reasoning in *Thelen*. To the contrary, California has rejected – and this Court should continue to reject – the purported policy justifications offered in *Thelen*.

First, *Thelen* is wrong to suggest that applying the unfinished business rule to law firms would create an "unjust windfall" for trustees. (24 N.Y.3d at 31-32.) Requiring a portion of the profits from unfinished business matters to be returned to creditors to partially satisfy the firm's unpaid bills and payroll is not unjust; it is the most equitable result.

Second, *Thelen* claims that lawyer mobility would suffer because "attorneys would simply find it difficult to secure a position

in a new law firm" if they were forced to remit profits. (*Id.* at 32.) This unsupported speculation is belied by the reality in these very cases. All of these Law Firm Respondents brought on Heller partners knowing that the Unfinished Business Rule existed. The risk of having to share profits with creditors did not stop them. Finally, as noted, unlike New York, California's governing statute allows for "reasonable compensation" for the work winding up unfinished business, undermining *Thelen*'s concern that successor firms would suffer undue hardship.

Third, *Thelen* suggests that "clients might worry that their hourly fee matters are not getting as much attention as they deserve if the law firm is prevented from profiting from its work on them." (*Id.* at 32.) That the argument is made can be seen as a sad commentary on the apparent state of the profession. The rules of conduct that govern California lawyers require them to take their responsibilities to clients seriously. It is only the law firms themselves that give clients a notion that they should worry that a California lawyer's competence and commitment will rise or fall depending on the profitability of a given client matter.[24]

In addition to the lack of merit, California courts reject the notion that client choice exempts lawyers from their fiduciary duties. *Jewel* itself explains that "the right of a client to the attorney of one's choice and the rights and duties as between partners with respect to income from unfinished business are distinct and do not offend one another." (*Jewel*, 156 Cal.App.3d at 178.)

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[24] Law firms routinely discount fees and use a variety of fee arrangements that impact profitability, but not zealous advocacy.

VIII. THE RIGHT OF A DISSOLVING PARTNERSHIP TO AN ACCOUNTING FROM ITS PARTNERS FOR THE PROFITS FROM UNFINISHED HOURLY BUSINESS MATTERS IS A PROPERTY INTEREST UNDER CALIFORNIA LAW.

A dissolved law firm's interest in the profits from the unfinished hourly business matters establishes a property interest of the dissolved firm. California law defines property rights broadly. (Cal. Civ. Code §§ 654-655.) Property includes qualified ownership, such as when the use of property is restricted. (Cal. Civil Code § 680.) A cause of action is a property right under California law.[25] (Cal. Civil Code § 953 (including a "thing in action" among property rights). Contractual rights are considered a chose in action and thus a form of property. (*In re Marriage of Brown* (1976) 15 Cal.3d 838, 845.) The Code of Civil Procedure specifies that, "When used in reference to property, 'interest' includes any right, title, or estate in property." (Cal. Code Civ. Pro. § 1235.125; see also Law Revision Commissions Comments) ["Section 1235.125 . . . is broadly defined to include all interests in property of whatever character or extent."])

The right of a partnership to enforce the duty of its partners to "account and hold for it any . . . profit . . . derived by the partner in the conduct or winding up of the business" California Civil Code section

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[25] See also Cal. Civ. Code § 655 ("There may be ownership of all inanimate things which are capable of appropriation or of manual delivery; of all domestic animals; of all obligations; of such products of labor or skill as the composition of an author, the good will of a business, trademarks and signs, *and of rights created or granted by statute.*" [emphasis added].)

16404(b)(1) and its rights with respect to the unfinished business of the firm on dissolution, fall well within the California constructions of "property" and "property interest."

Law partnerships, both in dissolution and out of dissolution, have a right to protect their interests in the firm's unfinished business and the profits generated from such business. For example, in *RMS I*, the Court of Appeal held that, "It is clear that a partner completing unfinished business cannot cut off the rights of the other partners in the dissolved partnership by the tactic of entering into a 'new' contract to complete such business." (146 Cal.App.3d 220, 219.) To the contrary, the partner's "fiduciary duty to complete the unfinished business on behalf of the dissolved partnership . . . governs the partner's future conduct regarding this business" and prevents the partner from capturing all of the profits for herself.

In a related vein, not only is a law partnership entitled to protect its contractual property interests in its unfinished business from the partners owing it fiduciary duties, but a law partnership can protect its interest in its unfinished business from interference by third parties. (*Abrams & Fox, Inc. v. Briney* (1974) 39 Cal.App.3d 604, 607-08.) (law firm entitled to pursue cause of action against a third person for interfering with attorney-client engagement agreement, even though client had an absolute right to terminate attorney at will); (*Skelly v. Richman* (1970) 10 Cal.App.3d 844, 862.) ("The right of client to terminate the attorney-client relationship at will does not justify breach inducement by a third party.").

The broad construction of property rights and interests that applies in California is further demonstrated because California courts

recognize that historical precedents and statutes are not the exclusive source for recognizing a property interest. Instead, California law views "property" as an evolving concept that takes into account contemporary commercial realities. (See *Lugosi v. Universal Pictures*, (1979) 25 Cal.3d 813, 841 [dissenting opinion].) ("[T]he concept of 'property' is not static but changes to accommodate creative developments and novel legal relationships.").[26]

Over the last several decades, the question of whether a property interest exists has come up most frequently in the context of challenges asserting a deprivation of that interest without due process. The law developed in that area quite consistently recognizes property interests where state law rules and understandings create a "legitimate claim of entitlement" to the asserted interest. (*Skelly v. State Personnel Bd.* (1975) 15 Cal.3d 194, 207.) For example, a person is

[26] The scope of what qualifies as an "interest" may be transferred under federal fraudulent transfer law is very broad as well. Although the Bankruptcy Code determines what is "property of the estate" under 11 U.S.C. § 541, state law is relied upon to determine the nature and extent of a debtor's interest in property. (*In re Dumont,* (9th Cir. 2009) 581 F.3d 1104, 1112.) [citing *Butner v. U.S.* (1979) 440 U.S. 48, 54.] Heller's interest in the profits from unfinished business matters, created by, and enforceable under, California's RUPA and *Jewel*, constituted a "legal or equitable interest" in such profits within the broad definition of "property of the estate" under Section 541 of the Bankruptcy Code. Absent the *Jewel* waiver, Heller had rights to enforce the partners' obligation to turn over profits from the matters pending at the time of Heller's dissolution and to protect its contractual rights in the unfinished business matters. For purposes of avoiding fraudulent transfers, Section 101(54) of the Bankruptcy Code defines "transfer" as "each mode, direct or indirect, ...of disposing of or parting with—(i) property; or (ii) an interest in property."

considered to have a property interest in continued utility service where state laws prohibit termination of service without notice. (*H & M Associates v. City of El Centro* (1980) 109 Cal.App.3d 399, 414) (Staniforth, J., concurring [recognizing a property interest in continued utility service because "Under present state law a utility may not terminate service to a residential dwelling on account of nonpayment of delinquent account unless notice is given at least seven days prior to proposed termination. Nor shall termination be carried out during the pendency of the investigation of a consumer complaint or dispute."]). Admitting privileges at a private hospital also are considered a property right. (*Anton v. San Antonio Community Hosp.*, (1977) 19 Cal.3d 802.) ("'Although the term 'hospital privileges' connotes personal activity and personal rights may be incidentally involved in the exercise of these privileges, the essential nature of a qualified physician's right to use the facilities of a hospital is a property interest which directly relates to the pursuit of his livelihood.'" (*quoting Edwards v. Fresno Community Hosp.*, (1974) 38 Cal.App.3d 702, 705.)

The property interest of a dissolving law firm in the profits from unfinished hourly business matters (that is, the gross revenues realized less "reasonable compensation" for completing the work), is anchored in existing statutes, rules, and understandings that create in the dissolving firm (and its creditors) a legitimate expectation of entitlement to those revenues. The existing framework is what led to the implementation of the *Jewel* Waiver in the first place.

Absent a modification of the default rules under the UPA and RUPA in the partnership agreement, the dissolving law firm is viewed

as the holder of the beneficial interest in any "property, profit, or benefit derived by the partner" in winding up the partnership business or that stems from a partnership opportunity. As the Unfinished Business Rule became more established, law firms became more keenly aware of its implications, and creditors of dissolving law firms have enforced the firm's unfinished business claims. In other words, private parties have based their behavior in the commercial world on the idea that – absent a valid waiver in a dissolving law firm's partnership agreement – the law firm is entitled to the profits on its unfinished business.

CONCLUSION

The fiduciary obligations of partners to each other and to the partnership are of the highest character. The fiduciary duties law partners owe to each other and to the law firm run deep. The Unfinished Business Rule is anchored in these time honored duties. In the context of a dissolving law partnership and the partnership's creditors, the rule imposes important duties and obligations on law firm partners with respect to the firm's non-lawyer employees, to associates and other non-partner lawyers, and to the public. The codification of these obligations in California's partnership acts honors these fiduciary duties and dictates the outcome here. This Court should confirm that a dissolved law firm has a property interest in the profits earned by its partners from completing the hourly unfinished business matters pending at the time the law firm is dissolved.

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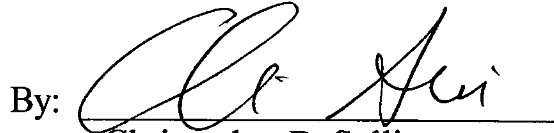
Respectfully Submitted,

Date: November 29, 2016 **DIAMOND McCARTHY LLP**

By: 

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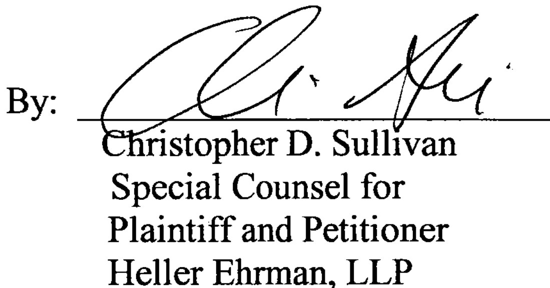
CERTIFICATE OF COMPLIANCE

I hereby certify that this brief has been prepared using proportionately one and one half spaced, 14 point, Times New Roman typeface. According to the "Word Count" feature in my Microsoft Word for Windows software, this brief contains 12,506 words up to and including the signature lines that follow the brief's conclusion.

I declare under penalty of perjury that this Certificate of Compliance is true and correct and that this declaration was executed on November 29, 2016

DIAMOND MCCARTHY LLP

By: 

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PROOF OF SERVICE

State of California, County of San Francisco

I hereby declare under penalty of perjury pursuant to the laws of the State of California that I am a citizen of the United States, over the age of 18 years, and not a party to the within action. My business address is 150 California Street, Suite 2200, San Francisco, CA 94111.

On November 29, 2016, I served true copies of the **OPENING BRIEF** on the interested parties in this action as follows:

PLEASE SEE ATTACHED SERVICE LIST

X (BY MAIL) I caused such envelope(s) with postage thereon fully prepaid to be placed in the U.S. mail at San Francisco, California.

____(BY FACSIMILE) I caused such documents to be delivered by facsimile transmission this date to the offices of the addressee(s), to the fax number noted herein.

____(BY PERSONAL SERVICE) I caused such envelope(s) to be delivered by hand this date to the offices of the addressee(s).

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____(STATE) I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

X (FEDERAL) I declare that I am employed in the office of a member of the bar of this court at whose direction the service was made.

Executed on November 29, 2016 at San Francisco, California.

Michaela M. O'Rourke

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Supreme Court Case No: S236208

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