No. S236208

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

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HELLER EHRMAN LLP,

Plaintiff and Petitioner,

v.

DAVIS WRIGHT TREMAINE LLP & FOLEY & LARDNER LLP

Defendants and Respondents.

AND RELATED CASES

Question Certified by the United States Court of Appeals
for the Ninth Circuit
Case Nos. 14-16314 & 14-16317

ANSWER BRIEF OF DAVIS WRIGHT TREMAINE LLP AND FOLEY & LARDNER LLP

STEVEN A. HIRSCH, #171825
shirsch@kvn.com
STEVEN P. RAGLAND, #221076
sragland@kvn.com
KEKER, VAN NEST & PETERS LLP
633 Battery Street
San Francisco, CA 94111-1809
Telephone: 415 391 5400
Fascimile: 415 397 7188

Attorneys for Davis Wright Tremaine LLP, Defendant and Respondent

PETER P. MERINGOLO, #197136
peter@pmrklaw.com
LUTHER K. ORTON, # 54258
lutherorton@icloud.com
PMRK LAW, LLP
One Sansome Street, Suite 3500
San Francisco, CA
Telephone: 415 964 4445
Facsimile: 415 962 4446

Attorneys for Foley & Lardner LLP, Defendant and Respondent

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shirsch@kvn.com
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sragland@kvn.com
KEKER, VAN NEST & PETERS LLP
633 Battery Street
San Francisco, CA 94111-1809
Telephone: 415 391 5400
Fascimile: 415 397 7188

Attorneys for Davis Wright Tremaine LLP, Defendant and Respondent

PETER P. MERINGOLO, #197136
peter@pmrklaw.com
LUTHER K. ORTON, # 54258
lutherorton@icloud.com
PMRK LAW, LLP
One Sansome Street, Suite 3500
San Francisco, CA
Telephone: 415 964 4445
Facsimile: 415 962 4446

Attorneys for Foley & Lardner LLP, Defendant and Respondent

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I. INTRODUCTION

After years of costly and rancorous litigation, defendants DWT and Foley[1] are finally here before the highest court of California to defend the proposition that a law firm that agrees to be paid by the hour stops getting paid when it stops working.

Because that's all this case has ever been about. As it wended its way from the bankruptcy court to the district court to the Ninth Circuit to here, forests were felled and bathtubs of ink spilled by lawyers and judges alike; late nights were spent poring over yellowed treatises on partnership law (well, not really; we used Westlaw); but in the end, that simple proposition is all this case boiled down to.

How did this obvious truth become such a head-scratcher that it warranted the attention of teams of lawyers, three federal courts, and ultimately this Court? Several factors combined to bring us here.

1. **Money.** Recent years have seen the collapse of many large law firms that billed big corporate clients by the hour. Enterprising bankruptcy trustees saw an opportunity to claim huge awards in adversary proceedings based on the notion that shifting hourly matters

[1] "DWT" refers to defendant Davis Wright Tremaine LLP. "Foley" refers to defendant Foley & Lardner LLP. Throughout this brief, internal quotation marks and citations were omitted from quotations. Emphases within quotations were added unless otherwise noted.

from a bankrupt firm to a solvent one could be a "fraudulent transfer" under federal bankruptcy law.

2. Bad analogies. From the beginning, Heller's fraudulent-transfer theory was founded on the premise that contingent matters and hourly matters are the same, or similar enough to be treated the same way when the law firms handling them dissolve.

The problem is, they aren't. When a law firm dissolves and a client transfers a contingent matter to a new firm, the dissolved firm faces a very real risk of "work confiscation"—the prospect that months or years of hard work will go down the drain when the case settles or reaches judgment at the new firm and the new firm then keeps the entire fee. Under those circumstances, courts have rightly held that the old firm deserves some sort of remedy. Ordinarily the remedy lies in *quantum meruit*; but where the new firm consists entirely of partners from the old one,[2] partnership duties spring to life and the old firm may have the right to sue for an accounting to enforce its rights under the Revised Uniform Partnership Act.

The situation is entirely different with hourly matters. With an hourly matter, a law firm gets paid for its work each month (if it bills

[2] Many questions surround this prerequisite, but they need not detain us here. *See* Part II.B.3.a., below.

monthly); and so, when it dissolves, it has been fully compensated for all of its work. There is no risk of work confiscation if the client then transfers the case to a new firm capable of completing it. Yet for several years now, courts around the nation have been debating the issue posed here: Does a dissolved law firm have a property interest in an hourly matter that it no longer works on and that the client has transferred to a new firm that is doing all the work? Two years ago, the New York Court of Appeals answered that question with a resounding "no" in *In re Thelen LLP*, 24 N.Y.3d 16 (2014). But the issue remains unsettled in California.

3. **Legal myopia.** Lawyers have a way of reasoning their way to the edge of a cliff while staring resolutely at their toes and refusing to look up. This happens because the broad arc of thought gets chopped up into incremental case holdings and possibly distinguishable facts and complex doctrinal shifts and statutory revisions and before you know it . . . . The cure is to step back from the edge and ask the Big Question, which often begins with the words, "What kind of a world would it be if . . . ?"

Here, the Big Question is:

> What kind of a world would it be if a dissolved and shuttered law firm—which has already been fully compensated for its work on an

> hourly matter—could keep feeding for months, years, or even decades on the hourly labor of the lawyers whom the client has chosen to complete that matter, siphoning away the bulk of their profits while doing nothing at all for the client?

The answer is: It would be a world in which lawyers could not land safely at new firms when their old ones failed—because who wants a lawyer whose caseload has a giant parasite stuck to it, sucking out the profits? It would be a world in which the longtime clients of those lawyers have to abandon them and find new, unencumbered lawyers to handle the work. It would be a world in which firms suddenly and chaotically collapse at the first ill wind as partners try to pull their work away before their firm dissolves and that work becomes encumbered by accounting claims.

But that world can be avoided if, in response to the certified question, this Court holds as follows: "*Under California law, a dissolved law firm has* **<u>no</u>** *interest in legal matters that are in progress but not completed at the time the law firm is dissolved, when that firm had been retained to handle the matters on an hourly basis.*" For reasons set forth below, common sense, a due regard for the ordinary

meaning of English words, and many different strands of California law converge to compel just that result.[3]

II. DISCUSSION

A. The certified question must be analyzed in light of the issues "truly contested on a factual record" in the bankruptcy case pending in the Ninth Circuit.

Nearly two decades ago, in its first determination of a question certified under California Rule of Court 8.548, this Court upheld the constitutionality of the referral procedure while explaining that, in order to avoid an improper advisory opinion, the Court's decision must do two things: (1) "address *only* issues that are truly contested by the parties on a factual record" in the case pending in the referring court; and (2) dispose of those issues and be res judicata between the parties. *Los Angeles Alliance for Survival v. City of Los Angeles*, 22 Cal. 4th 352, 362 (2000) [hereinafter *Alliance*].

In this case, these jurisdictional and prudential requirements[4] help to focus the certified question on the issue "truly contested on a factual record" in the case pending in the Ninth Circuit—namely,

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[3] Alternatively, the "reasonable compensation" granted to former partners for winding up the dissolved law firm's business should be held as a matter of law to be equal to the negotiated hourly fee that the new firm is charging for performing that work. *See* Part II.D., below.

[4] "The rendering of advisory opinions falls within neither the functions nor the jurisdiction of this court." *Salazar v. Eastin*, 9 Cal. 4th 836, 860 (1995).

whether a dissolved partnership's waiver of its right to seek an accounting of post-dissolution profits from hourly cases can be a constructively fraudulent transfer under federal bankruptcy law. Below, we provide the requisite background concerning that issue.

1. In *Jewel v. Boxer*, 156 Cal. App. 3d 171 (1984), the California Court of Appeal applied the then-existing Uniform Partnership Act ("UPA") to hold as follows: Post-dissolution profits[5] generated by contingent-fee matters[6] pending at a law firm when it dissolved must be shared among the partners as though the firm had *not* dissolved—that is, according to each partners' percentage interest in the dissolved partnership—regardless of who actually completed that work. *See id.* at 176 & n.2, 179–81 & n.4; *In the Matter of Heller Ehrman LLP*, 830 F.3d 964, 969 (9th Cir. 2016) [hereinafter *Heller*].

2. Under this "*Jewel* doctrine," former law partners can sue each other for an accounting of the post-dissolution profits generated by the dissolved firm's contingent matters. *See Jewel*, 156 Cal. App. 3d at

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[5] The *Jewel* court referred to those profits as "net post-dissolution income," meaning gross income less "reimbursement for reasonable overhead expenses (*excluding partners' salaries*)." 156 Cal. App. 3d at 180; *see also id.* at 180 n.6. The italicized phrase reflected the UPA's ban on extra compensation for partners engaged in winding up the business of a dissolved partnership.

[6] *See* Part II.B.2.b.(i), below (discussing *Jewel's* focus on contingent cases).

181. Alternatively, partnerships may opt out of *Jewel's* default rule contractually (and, indeed, were encouraged to do so by the *Jewel* court itself). *See id.* at 180–81. Under one common type of opt-out agreement, called a "*Jewel* waiver," partners give up their rights to assert post-dissolution *Jewel* claims against each other.

3. The fact that *Jewel* was decided under the UPA is significant because, in 1996, California adopted the Revised Uniform Partnership Act ("RUPA"), which changed the rules on which the *Jewel* decision was premised. *See Heller*, 830 F.3d at 967 n.1. Under the UPA (and before that, common law), a partner was not allowed any extra compensation[7] for winding up her law firm's unfinished business after it dissolved. *See* former CAL. CORP. CODE § 15018(f) (1995).[8] The *Jewel*

[7] As used in *Jewel*, "extra compensation" meant "receipt by a former partner of the dissolved partnership of an amount of compensation which [was] greater than would have been received as the former partner's share of the dissolved partnership." *Jewel*, 156 Cal. App. 3d at 176 n.2.

[8] Former UPA § 15018(f) stated 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 affairs." Thus, "the Uniform Partnership Act unequivocally prohibit[ed] extra compensation for post-dissolution services, with a single exception for surviving partners." *Jewel*, 156 Cal. App. 3d at 176–77. RUPA § 16401(h), by contrast, states that "[a] partner is not entitled to remuneration for services performed for the partnership, *except for reasonable compensation for services rendered in winding up the business of the partnership*."

court therefore felt compelled to reject an award of reasonable compensation to the winding-up partners. Under the RUPA, however, reasonable compensation became available, which "suggests that former partners now have a claim to some or all of their hourly rate for working on unfinished business." *Heller*, 830 F.3d at 969 (citing RUPA § 16401(h)).[9] The RUPA also permitted a former partner, for the first time, to compete with the dissolved firm while it is winding up its affairs.[10] *See* RUPA § 16404(b)(3); RUPA section 404, cmt. 2.[11] There is no dispute that RUPA governs here. *See* Heller's Opening Brief ("Heller Br.") at 1.

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[9] As used here, a number following the term "RUPA §" refers to a section of the California Corporations Code. "RUPA section" refers to a comment in the 1997 final draft of the RUPA by the National Conference of Commissioners on Uniform State Laws. *See* http://www.uniformlaws.org/shared/docs/partnership/upa_final_97.pdf.

[10] Under the RUPA, a dissolved partnership continues in existence until the business is wound up. Often only in retrospect is it possible to determine when the partnership ceased to exist. *See* ALLAN DONN, ROBERT W. HILLMAN & DONALD J. WEIDNER, REV. UNIFORM PARTNERSHIP ACT, authors' cmt. on § 802 (2016–2017 ed.).

[11] Section 16404(b)(3) states that "[a] partner's duty of loyalty to the partnership and the other partners includes . . . . [t]o refrain from competing with the partnership in the conduct of the partnership business *before the dissolution of the partnership*." Comment 2 explains that "the duty not to compete applies only to the '*conduct*' of the partnership business; it does not extend to *winding up* the business, as do the other loyalty rules. Thus, a partner is *free to compete immediately upon an event of dissolution* . . . unless the partnership agreement otherwise provides."

3. Heller dissolved in 2008 and became unable to serve any clients. Indeed, it effectively fired its clients. Those clients hired other law firms to complete hourly matters that remained unfinished at Heller when it dissolved ("the hourly matters"). Some of those firms hired former Heller shareholders or accepted them into their partnerships. Two such firms were defendants DWT and Foley. *See Heller*, 830 F.3d at 971–72.

4. As part of Heller's written dissolution plan, its shareholders entered into a *Jewel* waiver in which Heller gave up "any rights and claims under [*Jewel*] to seek payment of legal fees generated after the departure date of any lawyer . . . *with respect to non-contingency/non-success fee matters only* . . . ."[12] *Heller*, 830 F.3d at 871. Thus, the Heller *Jewel* waiver applied only to the hourly matters pending at Heller when it dissolved—not to pending contingent-fee matters.

5. Two months after Heller closed its doors and DWT and Foley had hired former Heller shareholders, Heller sought federal bankruptcy protection under Chapter 11. Ten months after that, Heller's trustee filed an adversary proceeding alleging that the *Jewel* waiver as to hourly matters had been a constructively fraudulent

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[12] ER155.

transfer of a valuable property interest from the insolvent Heller firm to its departing shareholders, and thence to other law firms that those shareholders later joined. These other law firms allegedly accepted the hourly matters as "subsequent transferees" under 11 U.S.C. § 550(a)(2). *See Heller*, 830 F.3d at 971. Heller named as defendants 49 law firms that had hired those partners, including DWT and Foley.

6. Heller often has engaged in strategic obfuscation concerning the specific nature of the fraudulently transferred property interest, which it has variously characterized as (a) the hourly matters themselves, (b) the stream of income flowing from those matters, or (c) the right to sue former shareholders and their new firms for an accounting of that income. Here, Heller's argument assumes that it possesses some direct ownership interest in the hourly matters themselves, which it characterizes as "partnership business" or "partnership property" within the meaning of RUPA § 16404(b)(1). *See* Part II.B.2.a., below.

7. Heller's adversary proceeding invokes the constructively fraudulent transfer statute, 11 U.S.C. § 548(a)(1)(B), which provides that the bankruptcy trustee may avoid any "transfer" of a debtor's "property" interest if (*inter alia*) the transfer occurred two years or less before the debtor filed its bankruptcy petition and the debtor received

less than a "reasonably equivalent value" in exchange. The U.S. Supreme Court has interpreted the unusual phrase "reasonably equivalent value" in § 548 to mean "a price that approximated [the property's] worth at the time of sale" (meaning, in this context, at the time of the *Jewel* waiver that effectuated the purported "transfer"). *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 538–39 (1994) [hereinafter *BFP*]. Section 548(a)(1)(B) thus requires courts to compare the property's approximate "actual value at the time of the sale"[13] with the value that the debtor received from that sale. The "property" interest itself is one defined by state law. *See Heller*, 830 F.3d at 969–70. Accordingly, there can be no constructively fraudulent transfer unless the state-defined property interest is susceptible to a non-speculative[14] estimate of its "actual value" at the time of transfer—meaning, again, at the time of the *Jewel* waiver.[15]

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[13] *BFP*, 511 U.S. at 546; *see also id.* at 539; *In re Crystal*, 513 B.R. 413, 419 (Bankr. D. Idaho 2014).

[14] *Cf. Julian Petroleum Corp. v. Courtney Petroleum Co.*, 22 F.2d 360, 362 (9th Cir. 1927) (noting that, "as a general rule, remote, uncertain, and speculative damages are not recoverable"); *see also Piscitelli v. Friedenberg*, 87 Cal. App. 4th 953, 989 (2001).

[15] California's Uniform Fraudulent Transfer Act ("UFTA"), also invoked by Heller, likewise states that a transfer made by a debtor is fraudulent as to a creditor if the debtor made the transfer without receiving a "reasonably equivalent value" in exchange for the transfer. CAL. CIV. CODE § 3439.04(a)(2). Like its federal counterpart, the UFTA

8. Heller claims that the fraudulently transferred property interest was created by California partnership law, which allegedly grants a dissolved law firm a legally enforceable right to siphon away the profits generated by hourly matters on which the dissolved firm is doing no work, for as long as it takes *other* law firms and lawyers, chosen by the client, to complete those matters.

This background makes it possible to approach the certified question with due regard for the context in which it arose and in which it must be decided if the resulting opinion is to be non-advisory. The question is:

> 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 firm had been retained to handle the matters on an hourly basis?

The answer to that question is "none," unless the Court is willing to accept two mistaken propositions, each of which the defendants "truly contested . . . on a factual record"[16] in the bankruptcy case:

1. California partnership law grants a dissolved law firm that no longer can provide legal services an enforceable "property interest" in the future profits from hourly matters that were pending at the firm

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requires an *ex ante* valuation of the transferred property. *See In re JTS Corp.*, 617 F.3d 1102, 1109 (9th Cir. 2010).

[16] *Alliance*, 22 Cal. 4th at 362.

when it dissolved and that the clients then transferred to firms capable of working on those matters.

2. This property interest has the necessary attributes to become the subject of a constructively fraudulent transfer under 11 U.S.C. § 548(a)(1)(B). In other words, the proposed property interest must be capable of being (a) "transferred" by a law firm to its individual partners, without the consent of the clients, by means of a *Jewel* waiver between partners and (b) assigned a non-speculative monetary value *ex ante*—i.e., as of the time of transfer and not in hindsight.

A decision recognizing some other type of property interest could not dispose of the issues "truly contested by the parties on a factual record" in the federal bankruptcy case and would therefore be purely advisory and improper. For example, an abstract "interest" that did not qualify as a "property" interest would not be relevant, and an opinion recognizing its existence would be advisory.[17] So would an opinion recognizing the existence of a "property interest" whose value could be ascertained only in hindsight, months or years after the putatively fraudulent transfer occurred.

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[17] This Court deleted the word "property" from the Ninth Circuit's certified question. But 11 U.S.C. § 548(a)(1)(B) refers to "an interest of the debtor in *property*." Thus, the only relevant kind of interest here is a property interest.

As demonstrated below, California partnership law does not and should not recognize any property interest having these characteristics. Accordingly, the answer to the certified question is "none": Under California law, a dissolved law firm has no relevant property interest in hourly legal matters that were in progress but not completed at the time the law firm was dissolved.

B. California partnership law does not—and should not—grant a dissolved law firm an enforceable interest in receiving unearned compensation from an hourly matter that the client has taken to another firm.

Heller purports to find in California partnership law the authority, or at least the principles, that would permit a dissolved law firm to obtain a stream of income for years in return for doing no further work on an hourly matter for which it has been fully paid and that its former client has taken to another firm.

As the Ninth Circuit and this Court concluded when formulating and accepting the certified question, no controlling precedent recognizes such an interest;[18] and as demonstrated below, the proposed interest lacks support in the RUPA or in any relevant California

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[18] *See* CAL. RULES CT. r. 8.548(a) (stating that the Supreme Court may decide a certified question of California law "if," *inter alia,* "[t]here is no controlling precedent").

partnership case or principle. And that is as it should it be, because the proposed interest would pose a significant threat to client welfare.

1. Common sense as well as California law and policy support a nearly universal "no work, no pay principle."

It's common sense, it's basic math, and it's also a basic fact of life: Absent some special contractual or statutory entitlement, a service provider who agrees to be paid by the hour gets paid zero dollars for an hour in which he does zero work.[19] As a corollary, the provider cannot then turn around and claim some sort of "property interest" in being paid for an hour of doing nothing.

That's the position in which Heller finds itself: It agreed to an hourly rate of compensation for working on a variety of matters; it

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[19] *See, e.g., Gonzalez v. Downtown LA Motors, LP*, 215 Cal. App. 4th 36, 48 (2013) (observing that "the policies underlying California's minimum wage law and regulations . . . reflect a strong public policy in favor of full payment of wages for all *hours worked*"); *Laffitte v. Robert Half Int'l Inc.*, 1 Cal. 5th 480, 489 (2016) (observing that "lodestar-multiplier" method of calculating class-action attorney fees begins by "multiplying the number of hours *reasonably expended by counsel* by a reasonable hourly rate"); *Flannery v. Prentice*, 26 Cal. 4th 572, 590 (2001) (holding that attorney fees awarded under FEHA fee-shifting provision "belong, absent an enforceable agreement to the contrary, to the attorneys *who labored to earn them*"). As John Smith instructed the Jamestown colonists in 1609: "You must obey this now for a law, that he that will not work shall not eat . . . . For the labors of thirty or forty honest and industrious men shall not be consumed to maintain a hundred and fifty idle loiterers." Dennis Montgomery, *Captain John Smith*, COLONIAL WILLIAMSBURG J. (Spring 1994), *available at* https://www.history.org/foundation/journal/smith.cfm.

worked on those matters and received periodic payments from the clients for those hours of work; it stopped working on those matters after it dissolved and thereafter billed zero hours on them; and the clients accordingly took those matters to other law firms. At the moment of dissolution, therefore, Heller presumably had been fully compensated for all the hours of work it performed on the hourly matters;[20] and thereafter it did not and should not receive compensation for the hours of work that it *hasn't* been doing.

This "no work, no pay principle" applies as much to lawyers as to anyone else, as demonstrated by several California rules governing attorney fees. For example:

- Attorneys can't charge unconscionable fees—meaning fees that are excessive because they bear "no relationship to the amount of service provided or to be provided . . . to the client." *Champion v. Super. Ct.*, 201 Cal. App. 3d 777, 783 (1988); *see also* CAL. RULES PROF'L CONDUCT r. 4-200(A) (barring unconscionable fees); *cf.* CAL. RULES PROF'L CONDUCT r. 3-700(D)(2) (requiring terminated lawyer to promptly refund any part of advance fee payment that "has not been earned").

[20] To the extent that any outstanding bills for actual pre-dissolution work remain unpaid, Heller of course has the right to collect on those bills.

- Where lawyers who are not in the same firm agree to split fees with each other, the total fee must remain tethered to services actually rendered—or, as the pertinent rule puts it: "The total fee charged [must] not [be] increased solely by reason of" the fee-splitting agreement. CAL. RULES PROF'L CONDUCT r. 2-200(A). This rule protects the client from paying a higher fee just to fatten the wallet of a lawyer who did "nothing more than obtain[that client's] signature . . . upon a retainer agreement while the lawyer to whom the case [was] referred perform[ed] the work." *Chambers v. Kay*, 29 Cal. 4th 142, 148 (2002).
- A discharged attorney only has a right to a *quantum meruit* recovery to collect "the reasonable value of the services of *the services he has rendered* up to the time of discharge." *Fracasse v. Brent*, 6 Cal. 3d 784, 791 (1972). The same rule applies where the attorney or law firm became unable to continue working on the matter due to death, disability, or even elevation to the bench—situations analogous to a firm's dissolution and inability to further serve its clients. *See Cazares v Saenz*, 208 Cal. App. 3d 279, 285 (1989); *Rus, Miliband & Smith v. Conkle & Olesten*, 113 Cal. App. 4th 656,

671–72 (2003). Under that principle, the "reasonable value" of work *not* "rendered" post-dissolution is zero.

Despite these contraindications, Heller claims that California law carves out a special partnership exception to the "no work, no pay principle." Heller is wrong.[21]

2. California law creates no special "partnership exception" to the no-work, no-pay principle.

In the face of the ubiquitous and seemingly obvious "no-work, no-pay principle," Heller nevertheless asserts that a dissolved law firm has a special right to recover from other, functioning law firms "the profits generated by any [former] 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." Heller Br. 1.

[21] Heller falsely asserts that the defendants argue for a law-firm "exception" to the unfinished-business rule. Heller Br. at 36–38. As the Court will see, we present no such argument. We believe that the principles outlined here apply to all types of partnerships that perform hourly work. But that doesn't mean that defendants must shy away from arguments that take notice of the particular rules and policies relevant to legal matters and attorney-client relationships. We would be equally free to look to the relevant rules and policies in an accounting-firm case. Heller is again mistaken when it asserts that the New York Court of Appeals endorsed a law-firm exception in *Thelen*. Heller Br. at 38–39. It did no such thing. Ironically, *Heller* is the party arguing here for a special exception—a partnership exception from the universally acknowledged no work, no pay principle.

This entitlement to feed parasitically on matters completed entirely by other firms and lawyers supposedly continues until the "host"—the transferred hourly matter—ceases to exist.

As discussed below, Heller cites no partnership-related law or principle capable of supporting this exceptional property interest, even by analogy.

a. The RUPA, on its face, does not recognize the property interest proposed by the certified question.

Heller asserts that the proposed property interest derives from the so-called "unfinished business rule" allegedly codified by RUPA § 16404(b)(1). That provision states:

> **(b)** A partner's duty of loyalty to the partnership and the other partners includes . . . :
>
> > **(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.

Heller further asserts that a former partners' entitlement to "reasonable compensation and an allocation of overhead" for winding up the hourly matters of a dissolved firm arises from RUPA § 16401(h). That provision states:

> A partner is not entitled to remuneration for services performed for the partnership, except for reasonable compensation for services rendered in winding up the **business of the partnership**.

These RUPA provisions focus attention on the question whether an hourly matter pending at a law partnership when it dissolves remains the partnership's "business" or "property" after the dissolved firm stops working on the matter and the client takes it to a different firm.

RUPA, on its face, does not answer that question. That's no surprise: Partnership law "does not define property; rather, it supplies default rules for how a partnership *divides* property as elsewhere defined in state law. As a result [it] has nothing to say about whether a law firm's 'client matters' are partnership property." *Thelen*, 24 N.Y.3d at 28 (emphasis in original) (interpreting New York law).[22] No RUPA provision explicitly endorses or rejects the proposed property interest. But common sense, respect for the English language, and California precedents and policies all combine to compel one answer: the proposed property interest does not exist.

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[22] RUPA "defines" "property" as "all property, real, personal, or mixed, tangible or intangible, or any interest therefrom"—in other words, property is anything that could be property. CAL. CORP. CODE 16101(15). This circular non-definition does not help to resolve the question presented here.

(i) Hourly matters cannot be "partnership business" after the dissolved firm has stopped working on them and the client has taken them to a different firm.

To begin with, hourly matters that a dissolved firm can't handle and isn't working on, and that the client consequently has taken to another firm, *cannot* be the dissolved firm's "business." The relevant definition of "business" is "a usually commercial or mercantile *activity* engaged in as a *means of livelihood*,"[23] or "[t]he *activity* of . . . *selling* . . . commodities, products, or services."[24] Partnership "business" is therefore something that the partnership *does* in order to *make money*. As any parent with an adult child still living in the basement will attest, sitting around doing nothing is not an "activity," much less one directed to the making of money.[25]

Moreover, the fact that the client has taken the hourly matter to a different firm that is capable of working on it precludes any finding that the matter remains the "business" of the dissolved firm. To put it bluntly: When the client says it's over, it's over. After all, "[t]he authority of a privately retained attorney to represent his clients is

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[23] https://www.merriam-webster.com/dictionary/business.

[24] http://www.thefreedictionary.com/business.

[25] As discussed below at Part II.B.2.b.(i), the analysis is different with respect to contingent cases, where the transferred matter may be viewed as an investment in which the dissolved firm retains a legitimate "property" interest.

derived from the client's selection of the lawyer." *Polk Cty. v. Dodson*, 454 U.S. 312, 329 (1981). Accordingly, "[a]n attorney's representation of a client ordinarily ends when the client discharges the attorney[.]" *Gonzalez v. Kalu*, 140 Cal. App. 4th 21, 28 (2006). Indeed, a discharged lawyer must *help* her client transfer the matter to a different lawyer by promptly releasing all client papers and property[26] and by signing a substitution-of-counsel form upon request.[27] Here, Heller effectively booted the clients out the door by dissolving and shutting down. The clients then took their cases elsewhere. Heller's claim that the very cases it ejected somehow remain its "business" deserves scorn.

Thus, the RUPA carves out no special partnership exception to the "no work, no pay principle" that would enable a dissolved law firm to claim that an hourly matter remains the firm's "business" even after the firm stops working on it and the client takes it to a new firm.

The other phrase used in the cited RUPA provisions is "partnership property"; but as discussed below, an hourly matter is *never* partnership property, before or after dissolution.

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[26] CAL. RULES PROF'L CONDUCT r. 3-700(D)(1).

[27] *See Dixon v. State Bar*, 39 Cal. 3d 335, 343 (1985).

(ii) Hourly matters are *never* "partnership property"—because the client alone owns them.

The RUPA itself prevents a client's matter from being considered "partnership property." RUPA § 16204(a) states that property is "partnership property" if "acquired in the name of" the partnership or in the name of one or more partners, in an instrument indicating the partner's capacity as a partner or the partnership's existence. But client matters are never "acquired" by a law partnership under any name stated in any document—period. Even where a written fee agreement exists between firm and client, the agreement never says that the matter has now become, or will become, the law firm's property—a statement that would be laughable, as well as impossible to enforce, grossly unethical, and likely adequate grounds for suspension or disbarment.

The RUPA aside, many other strands of California law converge to support the conclusion that a client's matter is *never* the "property" of the law firm that represents him—much less the property of a dissolved firm that no longer represents him or any anyone else. As the New York Court of Appeals observed when addressing the same question under that state's law, "[a] law firm does not own a client or an engagement and is only entitled to be paid for services actually

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rendered." *Thelen*, 24 N.Y.3d at 22. Accordingly, that court held that "pending hourly fee matters are not partnership 'property' or 'unfinished business' within the meaning of New York's Partnership Law." *Id.*

Like New York law, California law is hostile to the notion that a law firm owns its client's matters. One key attribute of property ownership is "the right to dispose of a thing in every legal way." *Gen. Dynamics Corp. v. Los Angeles Cty.*, 51 Cal. 2d 59, 71 (1958) (McComb, J., concurring).[28] Under California law, the *client* has the exclusive right to dispose of a matter; his attorney does not. The client alone possesses authority to pursue, abandon, settle, or concede a matter, thereby terminating it and any stream of hourly fee payments that an attorney could earn from working on it.[29] By contrast, "an attorney is

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[28] The "Hohfeldian" theory of property adopted by many courts and scholars views "'ownership' [as] a collection of rights to use and enjoy property, including the right to sell" it. *Energy Oils, Inc. v. Montana Power Co.*, 626 F.2d 731, 736 (9th Cir. 1980); *see generally* CHRISTOPHER SERKIN, THE LAW OF PROPERTY 8 (2d ed. 2016) (discussing Hohfeldian view of property as a "bundle of rights").

[29] In one of the few areas of law where the client's right to dispose of the matter is restricted—class actions—the client still usually has the right to object to a classwide settlement, *see* FED. R. CIV. P. 23(e)(5), or to opt out of the action altogether. *See Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 810–11 (1985); *Hypertouch, Inc. v. Super. Ct.*, 128 Cal. App. 4th 1527, 1540 (2005), *as modified on denial of reh'g* (June 6, 2005); *cf. Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 833–36 (1999) (describing

not authorized merely by virtue of his retention in litigation to impair the client's substantial rights or the cause of action itself." *Knabe v. Brister*, 154 Cal. App. 4th 1316, 1323 (2007). His authority to bind the client without obtaining client consent is limited to issues that are "simply necessary or incidental to the management of the suit, and which affect only the procedure or remedy as distinguished from the cause of action itself, and the essential rights of the client." *Id.* at 1324.

For example, an attorney cannot, without client approval, settle a case, drop an essential defense, submit to a default judgment, agree to accept nominal damages, increase the amount of a judgment against the client, waive findings so that no appeal can be made, or submit the case to binding arbitration. *Id.* at 1324 (collecting cases); *see also Maddox v. City of Costa Mesa*, 193 Cal. App. 4th 1098, 1105–06 (2011); *Alvarado Cmty. Hosp. v. Super. Ct.*, 173 Cal. App. 3d 476, 480 (1985); Cal. State Bar Op. 1994-135; CAL. RULES PROF'L CONDUCT r. 3-510(A)(2). Relatedly, California courts will not enforce an agreement that requires a client to pursue an unwanted lawsuit, nor permit a lawyer to sue his client for abandoning a suit after the lawyer agreed to shift from an hourly fee to a contingent fee. *Lemmer v. Charney*, 195

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narrow circumstances in which mandatory class action may be justified).

Cal. App. 4th 99, 105 (2011). These constraints on the lawyer's autonomy belie any claim that he owns the matter.

Another strong indication of client ownership is the fact that the client enjoys absolute discretion over which lawyer, if any, will handle the matter. Precisely because the client's interest in the success of an action is "superior to that of an attorney," the client has "both the power and the right at any time to discharge his attorney with or without cause" when she "ceases to have absolute confidence" in the attorney's integrity, judgment, or ability. *Fracasse* , 6 Cal. 3d at 790.[30]

To the extent that the matter is regarded as a potential revenue-generating resource, the client's "right to exclude" any and all lawyers from handling and profiting from that resource implicates what some scholars regard as "*the* foundational [property] right—the right from which all others spring." CHRISTOPHER SERKIN, THE LAW OF PROPERTY 8 (2d ed. 2016) (emphasis in original) [hereinafter LAW OF PROPERTY].

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[30] Although the attorney-client relationship is one of special confidence and trust, *Fracasse,* 6 Cal. 3d at 789–90, the proposed property interest perversely springs into existence at the precise moment when the client's grounds for confidence and trust disappear—i.e., when the firm dissolves and no longer can do the client's work. As the district court noted in this case, "[t]o the extent dissolution does change the lay of the land, it should do so *in favor of Defendants* as a matter of equity," since "Heller ceased to be able to represents its clients, leaving them with no choice but to seek representation elsewhere." *Heller Ehrman LLP v. Davis, Wright, Tremaine, LLP,* 527 B.R. 24, 31 (N.D. Cal. 2014).

This "right to exclude" is "one of the most essential sticks in the bundle of rights that are commonly characterized as property." *Kaiser Aetna v. United States*, 444 U.S. 164, 176 (1979). Lawyers, by contrast, have no right to exclude other law firms from competing for and taking on client matters.

Thus, the RUPA lends no support to the mistaken notion that an hourly matter can be a law partnership's "property," either before or after the partnership dissolves.

b. Heller's pre-RUPA cases about contingent fees cannot help the Court answer the certified question.

Because the RUPA, on its face, fails to support the proposed property interest, Heller has long attempted to read the cited RUPA provisions in light of relevant California case law.

The problem with that approach is that there is no relevant California case law. As the Ninth Circuit correctly discerned, every citable California unfinished-business case either (1) concerns former partners' post-dissolution division of *contingent* fees, which present a fundamentally different issue than *hourly* fees (*see Heller*, 830 F.3d at 967–68); or (2) pre-dates California's adoption of the RUPA, which for the first time authorized post-dissolution competition between partners

and the payment of "reasonable compensation" to a former partner for winding up partnership business. *See Heller*, 830 F.3d at 969.

We will not waste the Court's time with a historical exposition of California unfinished-business case law that is unlikely to improve upon the Ninth Circuit's. *See Heller*, 830 F.3d at 966–69. What we will do, briefly, is summarize the legal and practical reasons why contingent-fee cases and pre-RUPA cases offer little help in resolving the certified question.

(i) Cases about the winding up of contingent matters cannot resolve the certified question concerning hourly matters.

With one exception discussed in the following section,[31] every published California "unfinished business" case on which Heller

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[31] *See Rothman v. Dolin*, 20 Cal. App. 4th 755 (1993), discussed in Part II.B.2.b.(ii), below. Heller implies by selective quotation that *Osment v. McElrath*, 68 Cal. 466 (1886), was another hourly-fee case (*see* Heller Br. at 18, 25); but as the Ninth Circuit recognized, it wasn't. *See Heller*, 830 F.3d at 966. For starters, hourly billing did not become the predominant method until the 1970s; before that, most fees were not only fixed but codified. Stuart L. Pardau, *Bill, Baby, Bill: How the Billable Hour Emerged as the Primary Method of Attorney Fee Generation and Why Early Reports of Its Demise May Be Greatly Exaggerated*, 50 IDAHO L. REV. 1, 3 (2013). Moreover, *Osment* contains several indications that contingent fees were the only ones in dispute. *See id.* at 470–73 (describing sixth assignment of error and defendant's correspondence). In any event, *Osment* did not discuss hourly matters or analyze the applicability of the no-compensation rule to such matters; and "an opinion is not authority for a proposition not therein considered." *Flannery*, 26 Cal. 4th at 581.

relies—including the landmark *Jewel v. Boxer* decision—involved the post-dissolution allocation of a contingent fee. The reason appears to be that, until the recent spate of bankruptcies of large law firms that bill large corporations by the hour, few dared to suggest that partnership law might grant a dissolved and shuttered law firm an ongoing stream of profits from hourly work done by someone else.

In any event, unfinished-business cases concerning contingent matters offer no guidance here because those cases involve a risk of "work confiscation" that is absent with respect to hourly matters. In a contingent matter, the lawyer is not paid for her work until the case ends weeks, months, or years later—and even then, she is paid only if the client obtains a favorable settlement or judgment. Discharge by the client therefore poses a special risk to a contingent-fee lawyer because "a client's absolute right to discharge an attorney in a contingency fee case allows the client, in effect, to *confiscate*" all the work that the lawyer has performed up to that point. *Rus, Miliband,* 113 Cal. App. 4th at 672. Courts ameliorate that inequity by granting the lawyer a *quantum meruit* remedy for "the reasonable value of the services he has

rendered up to the time of discharge." *Fracasse*, 6 Cal. 3d at 791; *see* Part II.B.1., above.[32]

A similar risk of confiscation arises when a law firm dissolves and becomes unable to complete a pending contingent matter. Unless the firm is granted some sort of remedy, it will no receive payment for the work it has done and thus will lose its entire investment in the case. The only difference from a client-discharge case is this: Where the attorney who is completing the work is a former partner in a dissolved firm, the remedy switches from *quantum meruit* to an accounting action to enforce the former partner's duty under RUPA § 16404(b)(1) to hold the proceeds of his winding-up work in trust for the dissolved firm. From a textual standpoint, it may make sense to view the former partner as having appropriated and benefited from the dissolved firm's prior investment in the case—that is, from the dissolved firm's

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[32] The amelioration is only partial because the contractually negotiated contingent fee usually "far exceeds the amount of *quantum meruit* recovery." *Huskinson & Brown, LLP v. Wolf*, 32 Cal. 4th 453, 460 (2004). The negotiated fee *has* to be higher to compensate the lawyer for (a) the risk of losing the case and obtaining no fee and (b) the opportunity cost of tying up resources in a nonpaying case for an extended period instead of investing them in hourly matters that yield immediate returns.

"property" within the meaning of RUPA § 16404(b)(1).[33] The duty to account therefore comes into play.

In the case of an hourly matter, by contrast, there is no danger of work confiscation. A law firm working on an hourly basis is paid in full after each billing period for each hour of work that it performed during that period.[34] Thus, when the firm is discharged—or when it dissolves and then fires or loses its clients—it has been fully compensated for all the hourly work it has done, and no confiscation can occur. The new firm that takes over the matter is *not* using the dissolved partnership's property or performing its business (*see* Part II.B.2.a., above); so even if the new firm has hired a former partner of the dissolved firm, the new

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[33] *See* Radek Goral, *The Law of Interest Versus the Interest of Law, or On Lending to Law Firms*, 29 GEO. J. LEGAL ETHICS 253, 260–61 (2016) (characterizing contingent-fee lawyer as a "professional litigation investor . . . whose net worth is stranded in lawsuits").

[34] Heller argues that recognizing the proposed property interest is the only way that dissolved law firms can recoup the resources they invested to attract hourly matters—e.g., investments in building practice areas, marketing, and developing lawyers. *See* Heller Br. 32–33. But Heller has never limited its fraudulent-transfer claim to reimbursement of those expenses. And the argument proves too much: Every business has marketing and personnel-development expenses—but that doesn't entitle them to siphon away the profits from someone else's hourly work when the client takes its business elsewhere (let alone when the firm's collapse effectively fires the clients). Presumably, a law firm builds those expenses into its calculations when setting its hourly rates; and conversely, a law firm presumably tries to limit those expenses based in part on its estimate of the rates that clients will pay for the services of its lawyers.

firm holds no partnership "property" or "business" that could trigger that partner's duty to account to his old firm.

Ironically, the property interest proposed in the certified question raises the specter of work confiscation once more—but in the opposite direction, and to an unprecedented degree. Now it is *the new firm that the client chose to complete the matter* whose work is being confiscated; and, equally bad, that work is being confiscated on an ongoing basis by a dissolved firm that no longer can serve the client and that *already has received all of the hourly compensation it was owed*. This "reverse confiscation"—the diversion of revenues from the client's current lawyer to his former one—is far worse than regular "forward confiscation" from the standpoint of client welfare and public policy. Forward confiscation—the diversion of revenues from the client's former lawyer to his current one—only hurts a lawyer who is no longer serving the client. Therefore, it cannot directly affect the quality of legal services that the client currently receives; nor can it constrain the client's choice of counsel. Reverse confiscation, by contrast, frustrates the client's reasonable intentions and expectations[35] and diminishes his

[35] Indeed, the proposed property interest reflects a callous disregard for the client's reasonable expectations. And those expectations matter. Case law concerning *quantum meruit* awards to attorneys emphasize that the attorney first must first show that "the circumstances were

current lawyers' incentives to serve him well. *See* Part II.B.3.b., below.

Failure to focus on the difference between contingent and hourly fees or to recognize the dangers of reverse confiscation has led bankruptcy courts in recent big-firm bankruptcies down a rabbit-hole of illogic in which they lost sight of the "no work, no pay principle." They failed to see that "unfinished business" cases concerning contingent fees—which is to say, all but one of the citable California unfinished-business cases—are of no help in answering the certified question.

(ii) Pre-RUPA cases, including the aberrant *Rothman v Dolin* decision, are no longer good law and cannot help to resolve the certified question.

The irrelevance of pre-RUPA cases already has been explained: the enactment of RUPA § 16401(b), which provides "reasonable compensation" for winding up partnership business, "suggests that former partners now have a claim to some or all of their hourly rate for working on unfinished business." *Heller*, 830 F.3d at 969. In addition, the RUPA permits former partners to compete with the dissolved firm

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such that the services were rendered under some understanding or expectation that compensation therefor was to be made." *Huskinson*, 32 Cal. 4th at 458. But no client *ever* harbors an "understanding or expectation" that his hard-earned fee payments, intended to incentivize his current lawyer, will instead be diverted to a defunct law firm that does no work. *See* Ninth Circuit Supplemental Excerpts of Record 14 ¶ 5 (former Heller client stating that he never expected or wanted DWT to have to share its fee receipts with Heller). Yet that is the result that would flow from recognizing the proposed interest.

while it is winding up its affairs. *See* RUPA § 16404(b)(3); RUPA section 404, cmt. 2; Part II.A.,¶3, above. Therefore, under RUPA—unlike in *Jewel*—a former partner may ask a client of the dissolved firm to enter into a new contract with a new firm without violating "the fiduciary duty not to take any action with respect to unfinished partnership business for personal gain." *Jewel*, 156 Cal. App. 3d at 178–79. Any discussion of the proposed property interest should be conducted in light of these changes. As the Ninth Circuit observed, "California's adoption of RUPA is material to the question raised in this case," as it casts doubt on the vitality of every citable California case in this area. *Heller*, 830 F.3d at 969.

Long stretches of Heller's brief attempt to downplay the importance of RUPA's departure from the no-compensation rule. *See, e.g.*, Heller Br. 17–32. The gist of these arguments is that there is a unitary doctrine called "the unfinished business rule" that emerged in common law, was codified without substantive change in the UPA, and was codified again without change in the RUPA. But that is simply not true.[36] The UPA banned extra compensation for winding up partnership

[36] One section of Heller's brief argues that several cases applied the "unfinished business" rule during and after California's enactment of the RUPA in 1996. *See* Heller Br. at 29–30. It is not clear what this discussion is supposed to prove, because both of the cited cases that

business, whereas the RUPA not only provides for extra compensation but allows the winding-up partner to compete with his old firm after dissolution. In this transformed legal environment, pre-RUPA cases are dinosaurs lumbering on their way to extinction.

One such dinosaur is *Rothman v. Dolin*, 20 Cal. App. 4th 755 (1993), the only published California decision ever to hold that a dissolved law firm has an interest in hourly matters handled elsewhere. Decided almost a quarter-century ago and largely ignored ever since, *Rothman*, like *Jewel*, was a pre-RUPA case founded on the UPA's no-compensation rule. The thinly reasoned four-page opinion parroted reasoning from *Jewel* and from *Fox v. Abrams*, 163 Cal. App. 3d 610 (1985)—two pre-RUPA cases about contingent fees—and then concluded with little discussion that the "policy reasons" behind *Jewel* "apply with equal force to both contingency and hourly rate cases." 20 Cal. App. 4th at 758. The court's holding seemed to be motivated by two concerns.

First, one of the former partners in the dissolved two-man firm had taken the firm's hourly cases while the other had taken its

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dealt with the "unfinished business" rule appear to have applied the UPA. *See Grossman v. Davis*, 28 Cal. App. 4th 1833, 1835–36 (1994); *Dickson, Carlson & Campillo v. Pole*, 83 Cal. App. 4th 436, 445 n.6 (2000); *see also Heller*, 830 F.3d at 967–68 & n.1.

contingent cases. The court seemed to believe that giving only the hourly-fee partner the benefit of a *Jewel* accounting would be unfair. It therefore granted the contingent-fee partner a reciprocal right to an accounting of fees from the hourly cases. *Id.* at 758–59. But why? Viewed through the lens of "work confiscation," it would have been perfectly fair to give only the hourly-fee partner an accounting remedy. At the time of dissolution, the firm presumably had been paid for all of its work on the pending hourly cases and for none of its work on the pending contingent cases. Yet the hourly-fee partner had invested in the contingent cases just as much as the contingent-fee partner had—by foregoing hourly income that the firm could have earned had it not taken on the contingent cases. His investment in the contingent cases would have been confiscated if the contingent-fee partner could have just taken the contingent cases without accounting back to the firm for the recoveries they eventually generated. By contrast, the contingent-fee partner faced no risk of work confiscation.

Second, the court speculated that discriminating between hourly and contingent cases "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 rather than the contingency fee cases upon dissolution." *Id.* at 758. Again: Why? It's the

client who decides which attorney gets which case; the lawyer ordinarily will not control that. And the client is likely to want to stick with the lawyer who has been handling the matter all along and knows it well. Cases—both contingent and hourly—demand from lawyers a massive investment of time and knowledge. Lawyers can't just don and doff them on a moment's notice like a loose-fitting jacket.

3. The proposed property interest threatens client welfare in at least three ways.

The proposed property interest is not only unsupported by the RUPA and existing precedent; it is also bad public policy. The proposed interest would restrict lawyer mobility and the client's choice of counsel, weaken the incentives that align lawyer and client interests, and contribute to sudden and disorganized law-firm breakups. Heller's countervailing policy interest—maximizing the resources available to its creditors—cannot outweigh the threat that the proposed property interest poses to client welfare.

a. Restricting lawyer mobility and thus the client's choice of counsel.

When a firm dissolves, lawyer mobility becomes the key to preserving the client's interest in continuity of representation[37] and his right to the lawyer of his choice. It is in the client's best interest that

[37] *See, e.g.*, *Kirk v. First Am. Title Ins. Co.*, 183 Cal. App. 4th 776, 809 (2010).

his trusted counsel land as swiftly and smoothly as possible at a new firm capable of supporting the client's work. But the proposed property interest is inimical to lawyer mobility and may "depriv[e] [the client] of representation by the very lawyer most familiar with the case and most desired by [that] client." *Champion*, 201 Cal. App. 3d at 783.

The problem is that the proposed property interest converts a former partner's business into a nonprofit, making the partner and his work unattractive to prospective employers. As the New York Court of Appeals explained, "[t]he notion that law firms will hire departing partners or accept client engagements without the promise of compensation ignores commonsense and marketplace imperatives." *Thelen*, 24 N.Y. 3d at 32. The court accordingly held that the proposed property interest "conflict[ed] with New York's strong public policy encouraging client choice and, concomitantly, attorney mobility." *Id.*

In California, the same policies should compel the same result. As the district judge in this case recognized, the proposed property interest would "all but force former Heller clients to retain new counsel with no connection to Heller or their matters." *Heller Ehrman LLP v. Davis, Wright, Tremaine, LLP*, 527 B.R. 24, 33 n.10 (N.D. Cal. 2014). As he correctly concluded, "[i]t is not in the public interest to make it more difficult for partners leaving a struggling firm to find new

employment, or to limit the representation choices a client has available, by establishing a rule that prevents third-party firms from earning a profit off of labor and capital investment they make in a matter previously handled by a dissolved firm." *Id.* at 33.

The proposed property interest further reduces the former partner's chance of employment by heightening the already considerable financial uncertainty that a law firm confronts when evaluating the income that a lateral hire might bring to the firm. As a result, the client may have to retain a different lawyer who already works for a firm capable of servicing the client. This is especially likely given the need to avoid lengthy breaks in representation.

Much of that financial uncertainty stems from *legal* uncertainty about which matters will and will not become subject to "unfinished business" claims. "Clarity and simplicity are vital here because a vague rule would condemn [law firms considering lateral hires] to endless speculation about when a client matter is new and when it is a carry-over of a prior engagement." *Hogan Lovells US LLP v. Howrey LLP*, 531 B.R. 814, 822–23 (Bankr. N.D. Cal. 2015) (discussing uncertainty felt by courts and litigants).[38] Even if the dissolved firm had the

[38] Property doctrines should promote certainty and thereby facilitate efficient resource allocation. But the proposed property interest does the opposite, introducing crippling new uncertainties into an already

foresight to adopt a *Jewel* waiver, litigation may erupt over the waiver's validity under federal bankruptcy law—as occurred here. *See* Amanda A. Main, *Applying the Unfinished Business Rule to Dissolved Law Partnerships*, 33 L.A. LAW. 10, 12–13 (Mar. 2010).

These uncertainties are sure to persist if the Court recognizes any variant of the property interest proposed by the certified question. Although such a decision would resolve basic uncertainty about whether the proposed property interest exists at all, endless follow-up questions will arise as new factual patterns emerge. For example:

- What if an hourly matter has been transferred between multiple firms over time? Does the dissolved firm's property interest tag along with the matter from firm to firm; or does the matter become "new" and unencumbered at some point?

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uncertain lateral-hiring process. *See, e.g., City of Berkeley v. Super.Ct.*, 26 Cal. 3d 515, 532 (1980) (observing that "uniformity and certainty in rules of property are often more important and desirable than technical correctness"); *Republic of Austria v. Altmann*, 541 U.S. 677, 693 (2004) (characterizing property rights as "matters in which predictability and stability are of prime importance"); Carol M. Rose, *The Shadow of the Cathedral*, 106 YALE L.J. 2175, 2198 (1997) (observing that the "impulse" behind property law is "to redefine and sharpen rights, so that actors can bargain for themselves and control their own investments"); *cf.* 1B LAWRENCE'S ANDERSON ON THE UNIFORM COMMERCIAL CODE § 1–103:196 (3d. ed. 2017) ("The primary purpose of the UCC is to facilitate commerce by codifying certain types of commercial dealings and making predictable the consequences of behavior.").

- What if an hourly matter involves designing a certain type of tax shelter or business transaction? Will all subsequent implementations of that design or transaction become part of the "unfinished" hourly business and subject to the dissolved firm's claims; or will they be new matters?
- What if the client wishes to transfer an hourly matter from a dissolved firm to a new firm where one or more former partners of the dissolved firm are, by coincidence, already working? Does the duty to account then attach to the matter rather than to the partner? Does it attach at all?
- What if the client transfers an hourly matter from a dissolved firm to a new firm that is already handling some of its other hourly matters?
- What if the client hires a firm to handle a trial on an hourly basis and then switches to a new firm to handle the appeal on an hourly basis after the trial firm dissolves? What if the client would have switched anyway because it prefers the new firm's appellate practice?
- If the new law firm wishes to avoid being sued for "unfinished business" claims, how should it go about deciding how much it needs to pay a potentially failing firm whose former partner it

wishes to hire—knowing that the partner's clients remain absolutely free to hire and fire lawyers and law firms at will?

Recognizing the proposed property interest in this case will not end these "almost metaphysical inquiries"[39]—it will release an avalanche of new ones. By contrast, these uncertainties will vanish like pricked bubbles if the answer to the certified question is that the proposed property interest does not exist.

b. Weakening the incentives that align lawyer and client interests.

The proposed property interest will harm clients even if they manage to retain their lawyer of choice, and even if that lawyer finds a new "platform" capable of handling the client's work. Even in those fortunate circumstances, client welfare remains at risk because the proposed interest weakens the financial incentives that align attorney and client interests.[40] For example, even if a new firm takes on the

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[39] *Hogan Lovells*, 531 B.R. at 822 (setting forth additional list of unanswered and possibly unanswerable questions).

[40] From an economic viewpoint, property exists "to make people better off by aligning incentives around the production and consumption of resources." LAW OF PROPERTY 21. Among other things, property can "encourage industry by ensuring that individuals can capture the benefits of their work—to reap what they have sown" and thus "make[] society as a whole better off." *Id.* "[R]ewarding effort and industry and discouraging unproductive claims" is therefore "part of the general story of property[.]" *Id.* at 58–59. The fact that the proposed property

partner and the client's work, the firm may not allocate the same level of resources to a profitless case that it would have allocated to a normal one. Once again, the client may need to retain a new lawyer—one who can be properly incentivized.

Nowhere is the alignment of incentives between principal and agent more important than in the attorney-client relationship—a relationship "of special confidence and trust"[41] characterized by the client's dependence on the attorney in matters of the highest importance to that client. The fiduciary duties that an attorney owes his client are even more stringent than those between partners. "Arguably, the term 'fiduciary' is inappropriate when used to describe the duties of a partner because a partner may legitimately pursue self-interest . . . and not solely the interest of the partnership and the other partners, as must a true trustee." RUPA section 404, cmt. 1. A lawyer, by contrast, "stands as a trustee for his client's interests—a most sacred and confidential relationship"—and therefore "has a constant

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interest actually *weakens* the incentives to work hard for the client is another sign that no such interest exists or should be recognized.

[41] *Fracasse*, 6 Cal. 3d at 789.

and perpetual rendezvous with ethics." *McClure v. Donovan*, 82 Cal. App. 2d 664, 666 (1947).[42]

It is therefore of critical importance to client welfare that the payments that a client makes to incentivize his lawyer not be siphoned away to an entity that no longer represents that client. If a client wants its work to follow a partner from one firm to another, the profits on that work must accompany that partner. The partner's interests thus remain at least roughly aligned with those of his client—the classic solution to the so-called "principal-agent problem."[43] But if courts sever the link between effort and reward, a partner who has joined a new firm may feel pressure to devote less time and energy to hourly matters

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[42] *See also Bradner v. Vasquez*, 43 Cal. 2d 147, 151 (1954) (noting that statutory presumption that trustee-beneficiary transactions are product of undue influence "has often been applied to contractual dealings between attorney and client because it is recognized that this relationship is one of a strict fiduciary and confidential nature"); 1 B.E. WITKIN, CAL. PROC. ATTYS § 90 (5th ed. 2008) ("An attorney, like a trustee, has a duty of loyalty to a client and the client's cause.").

[43] The difference between a *quantum meruit* recovery and a significantly higher negotiated contingent fee has been identified as a significant motivating factor for an attorney. *Cf. Hutchinson & Brown LLP v. Wolf*, 32 Cal. 4th 453, 460 (2004). By the same reasoning, a firm's knowledge that, on certain matters, its hourly compensation will be reduced from the normal negotiated hourly rate to some lower rate deemed "reasonable" in hindsight by a judge or jury may induce that firm to shift its resources to other matters.

from his old firm because those matters are now encumbered by accounting claims and have become far less profitable.

For these reasons, a client has every reason to be concerned when the law diverts his hard-earned incentive payments away from his current lawyer to a defunct firm that no longer serves him. Of all the difficulties provoked by the *Jewel* decision, perhaps none has been as pernicious as the misapplication by Heller and others of *Jewel's* statement that "[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." *Jewel,* 156 Cal. App. 3d at 178. This falsehood has been picked up in other cases, and Heller predictably seeks to exploit it here. *See* Heller Br. at 29–30 (citing cases).

Whatever its value in relation to contingent matters, the proposition that clients have no stake in the diversion of their incentive payments is obviously untrue with respect to hourly matters. A contingent-fee lawyer usually tries to optimize his level of effort—to do just enough on the case to obtain a satisfactory return on investment for herself and her client. She doesn't get paid for doing more, and she can't afford to do much less or she risks losing her entire investment in the case. Accordingly, the knowledge that she must share her fee with

her former law firm won't influence her level of effort as much as it would if she were paid by the hour.

By contrast, a client hires an hourly-fee lawyer to secure intensity of effort[44]—a safety margin entailing more work and more time than the lawyer would be likely to invest in the case if she were working on contingency. Thus, the lawyer enjoys greater discretion as to how much effort she expends, and she may devote more time to other matters if she knows that she must share her hourly fees with her former firm. The client may not be able to judge independently whether the lawyer is working as intensely as the client desires on the *Jewel*-encumbered matter.

This Court should reject *Jewel*'s cavalier dismissal of the client's interest in avoiding fee diversion. The New York Court of Appeals in *Thelen* recognized the seriousness of this problem, observing 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." 24 N.Y. 3d at 32. As that court observed, the proposed property interest "simply does not comport with

[44] *See* Anthony J. Sebok & W. Bradley Wendel, *Duty in the Litigation-Investment Agreement: The Choice Between Tort and Contract Norms When the Deal Breaks Down*, 66 VAND. L. REV. 1831, 1851–52 & nn.45–46 (2013) (comparing effects of hourly and contingent-fee arrangements on intensity of attorney effort).

our profession's traditions and the commercial realities of the practice of law today." *Id.* at 33.

c. Contributing to sudden and disorganized law firm breakups.

A law-firm dissolution is a difficult time for clients and lawyers alike. As a firm fails, diminishing resources and administrative upheaval create a significant risk that a pending client matter will be neglected or mismanaged. The California State Bar therefore admonishes that partners have an ethical obligation to manage dissolutions in an "orderly" fashion that avoids harm to clients. Cal. State Bar Standing Comm. on Prof'l Responsibility & Conduct, Formal Op. 2014-190. The Bar's opinion cautions that "failure to do so could violate each partner's duties under rule 3–700(A)(2) should a client suffer some reasonably foreseeable and otherwise avoidable prejudice as a result of the dissolution." *Id.*[45]

But the proposed property interest may trigger a dash for the exits that hastens or even causes a firm's collapse. *Jewel* accounting

[45] Rule 3–700(A)(2) states that "[a] member shall not withdraw from employment until the member has taken reasonable steps to avoid reasonably foreseeable prejudice to the rights of the client, including giving due notice to the client, allowing time for employment of other counsel, complying with rule 3-700(D) [concerning return of client papers, property, and unearned fee advances], and complying with applicable laws and rules."

duties attach only to those matters still pending at a firm when it dissolves.[46] *Jewel* therefore imposes no obligation on a lawyer who leaves a firm and persuades a client to follow him *before* dissolution. *See In re Heller*, 527 B.R. at 28–29. Partners who sense that their firm is in trouble therefore know that, if they wait to leave until after the firm becomes insolvent and dissolves, the matters they're working on may become encumbered by *Jewel* claims. And that may prompt the equivalent of a bank run—a cascade of withdrawals that renders a firm insolvent when it otherwise might have survived. This needless additional source of law firm instability cannot benefit clients.

The potential for destabilizing law firms motivated New York's highest court in *Thelen* to reject the proposed property interest. 24 N.Y. 3d at 31–32. As that court stated, the proposed property interest would encourage partners to "get out the door" as soon as possible rather than remain and work to bolster a struggling firm's prospects. *Id.*

d. ***Howard v. Babcock*** did not address the property interest or policy concerns at issue here.

Heller tries to counter these policy concerns by citing this Court's pre-RUPA decision in *Howard v. Babcock*, 6 Cal. 4th 409 (1993), to support "three key points: (1) pending matters are assets of a law firm;

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[46] Contingent matters, that is.

(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." Heller Br. 26.

To read Heller's brief, you would think that this Court decided the certified question 23 years ago. Heller manages to ignore the fact that *Howard* did not involve dissolutions, unfinished business, or the *Jewel* doctrine—let alone a dissolved law firm's purported property interest in hourly work that it can no longer perform and that its former client has transferred to another firm.

No—*Howard* was about something else. In *Howard*, this Court upheld a clause in a partnership agreement stating that a withdrawing partner who competed with his former firm in a specific practice area (liability-insurance defense), in specific courts (those of Los Angeles and Orange Counties), during a specific time period (the year following withdrawal), would forfeit specific withdrawal benefits (the interest on his capital and his right to continue receiving his partnership share of the firm's profits for one year after withdrawal). *Id.* at 412.

The legal issue was whether that withdrawal clause violated Rule of Professional Conduct 1–500, which (with various exceptions) prohibited agreements restricting a lawyer's ability to practice law. *Id.*

at 418–19. This Court held that "an agreement among partners imposing a reasonable cost on departing partners who compete with the law firm in a limited geographical area is not inconsistent with rule 1–500 and is not void on its face as against public policy." *Id.* at 425. The Court then ordered the case remanded to the trial court for a determination of whether the clause at issue was in fact reasonable. *Id.* at 426.

On the way to that result, the Court responded to arguments that enforcing such clauses would restrict a client's right to its choice of counsel. The Court observed that—as a practical matter—this right is not absolute, because a client can't always hire the lawyer it wants. The lawyer may cost too much, have a conflict, or simply not want the job. *Id.* at 423. The Court also speculated that this type of withdrawal clause might benefit clients by bolstering law firm stability, thereby making firms more willing to invest in the client's chosen lawyer. *Id.* at 424.

But *Howard* does not support recognition of the proposed property interest in hourly matters. The withdrawal clause in *Howard* was carefully circumscribed as to time, place, and type of practice. In contrast, the proposed property interest at issue here is radical. It calls for the ongoing redistribution of nearly all of the profits on all types of

unfinished hourly matters in all geographic areas for as long as it may take to complete those matters. The burden on client choice and on lawyers is far more onerous. Indeed, the proposed property interest, resting as it does on a fiction that firms own clients and their matters, betrays an "intent to relegate clients to the position of commodities"—an intent that the *Howard* court disavowed and that the far more limited penalty in that case did not imply. *Howard*, 6 Cal. 4th at 425–26.

As this Court likely surmised when it granted the certification request, *Howard v. Babcock* cannot dispel the many policy concerns triggered by the proposed property interest.

e. The threats that the proposed property interest poses to client welfare far outweigh the need to marshal every conceivable asset for the benefit of the dissolved firm's creditors.

Heller asserts that recognizing the proposed property interest is justified in order to maximize the assets of its bankruptcy estate and thus satisfy the claims of creditors harmed by the law firm's dissolution. *See* Heller Br. at 32. For three reasons, that argument must be rejected.

First, the creditor rationale proves too much. If maximizing the debtor's estate were the sole criterion for judging the debtor's claims, a trustee could sue anybody to recover anything. Bankruptcy is never

pretty. People and entities lose money. The hardships faced by departing partners should not be discounted, either. But Heller's claim to an indefinite stream of unearned income must stand on its own legal merits instead of piggybacking on the undoubted misfortunes suffered by anyone associated with a failed business.

Second, creditors—be they lenders, vendors, or former employees—are not fools. They all know, when deciding to do business or accept employment with a service provider, that no provider gets paid for work it doesn't do. No creditor reasonably expects that its interests will be protected in the event of bankruptcy by an indefinite inflow of revenues from other law firms now doing the hourly work that the dissolved firm cannot perform.

Third, even if a creditor maintained some unrealistic subjective belief in the firm's right to be paid for no work, that belief must yield to the client-welfare considerations outlined above. Throughout these proceedings, Heller has maintained a myopic focus on creditors' rights to the exclusion of any regard for client welfare. Heller forgets that the first obligation of any legal-services provider is to the clients. Duties that partners owe to each other, to their firm as an entity, or to their firm's creditors must take a back seat to ensuring client welfare.

C. The client's absolute right to hire and fire lawyers negates any possibility that the proposed property interest could become the subject of a constructively fraudulent transfer—the issue "truly contested" in the bankruptcy case.

As discussed, the proposed property interest does not exist. But even if some sort of interest existed, it would not be the kind that matters here. To be relevant to the matter pending in the referring court, a property interest must possess the necessary attributes to become the subject of a constructively fraudulent transfer under 11 U.S.C. § 548(a)(1)(B). Specifically, it must be capable of being (a) "transferred" by a law firm to its individual partners, without client consent, by means of a *Jewel* waiver among the partners and (b) assigned a non-speculative monetary value on an *ex ante* basis—i.e., as of the time of transfer and not in hindsight. *See* Part II.A., above. The proposed property interest satisfies neither requirement. Thus, an opinion recognizing that interest would be advisory. *See Alliance*, 22 Cal. 4th at 362.

1. The proposed property interest cannot be "transferred" by a *Jewel* waiver among partners.

Because the proposed property interest cannot be "transferred" by a *Jewel* waiver, it fails the test of relevance to the federal

bankruptcy case and an opinion recognizing its existence would be advisory.

Despite some equivocations, Heller continues to assume that it possesses some direct ownership interest in the hourly matters, which it characterizes as "partnership business" or "partnership property" within the meaning of the RUPA § 16404(b)(1). *See* Part II.B.2.a., above. But a *Jewel* waiver—which is nothing more than a contract between law-firm partners—is simply incapable of transferring the hourly matters themselves because the *clients* own them and exercise the exclusive right to "transfer" them from one law firm to another. *See Fracasse*, 6 Cal. 3d at 790; *Little v. Caldwell*, 101 Cal. 553, 561 (1894); Part II.B.2.a.(ii), above.

Thus, the proper answer to the certified question is that a dissolved law firm has no *relevant* property interest in hourly legal matters that were in progress but not completed at the time the law firm was dissolved.

2. The proposed property interest cannot be assigned a non-speculative monetary value as of the time of transfer.

Because the proposed property interest cannot be assigned a non-speculative monetary value as of the time of transfer, it fails the test of

relevance to the federal bankruptcy case and an opinion recognizing its existence would be advisory.

A dissolved law firm *cannot* prove that it received "less than a reasonably equivalent value" in exchange for a waiver of *Jewel* rights to future profits on its unfinished hourly matters. *See* 11 U.S.C. § 548(a)(1)(B)(i); Part II.A.¶7, above. The U.S. Supreme Court has held that the phrase "reasonably equivalent value" requires a "judicial inquiry into whether the [debtor's] property was sold for a price that approximated its worth *at the time of sale*." *BFP*, 511 U.S. at 538–39. Section 548 thus requires courts to compare the property's "*actual value at the time of the sale*"[47] with the value that the debtor received from that sale. As applied here, this means that the property must be valued *ex ante*, as of the time of transfer, when it was still a mere expectation of future business—not *ex post*, at some arbitrarily chosen later date during an adversary proceeding.

But the district court in the bankruptcy case correctly ruled that there is simply *no way to ascertain* the actual value of a dissolving firm's expectation of future profits on hourly matters at the time of transfer (i.e., when the partners signed a *Jewel* waiver). The court

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[47] *BFP*, 511 U.S. at 546; *see also id.* at 539; *In re Crystal*, 513 B.R. 413, 419 (Bankr. D. Idaho 2014).

observed that, because "[t]he client always owns the matter . . . the most the law firm can be said to have is an *expectation* of future business," and that Heller had been "unable to articulate a basis for calculating the value of this expected future business." *Heller Ehrman LLP*, 527 B.R. at 30. The court also rejected the trustee's suggestion that "the value at issue here is 'good will,'" noting that "[i]n California, and beyond, professional law partnerships do not have a 'good will' asset." *Id.* at 30–31 & n.7 (citing, *inter alia*, *Lyon v. Lyon*, 246 Cal. App. 2d 519, 526 (1966)). And any such asset would "disappear as soon as either (1) the client removes business, which it can do at will, or (2) the [dissolved] law firm ceases to be able to perform the work to generate those expected future profits." *Heller Ehrman LLP*, 527 B.R. at 31. The New York Court of Appeals likewise held that "future hourly legal fees" are "too contingent in nature and speculative to create a present or future property interest." *Thelen*, 24 N.Y.3d at 28.

Tellingly, in the bankruptcy-court litigation in this case, Heller effectively admitted that it would be impossible to come up with a non-speculative *ex ante* valuation of future hourly fee business. That is why Heller asked the bankruptcy court for an *ex post* valuation of the

unfinished hourly fee business based on fees received *as of the date of judgment in the adversary proceeding—years* after the dissolution.[48]

In sum: Even if one assumes that a *Jewel* waiver between partners could effectuate a "transfer" of client matters, that "property" would be nothing more than a purely speculative "expectation of future business" to which "no monetary value can be attributed." *Heller Ehrman LLP*, 527 B.R. at 30–31.

Once again, therefore, the proper answer to the certified question is that a dissolved law firm has no *relevant* property interest in hourly legal matters that were in progress but not completed at the time the law firm was dissolved.

D. Alternatively, the Court could interpret the phrase "reasonable compensation" in RUPA § 16401(h) as encompassing all of the compensation that the client agreed to pay its current law firm.

Even if the Court finds that a dissolved law firm has some sort of relevant property interest in hourly matters that were pending at dissolution and are now being handled by other lawyers, the Court still could invoke the "reasonable compensation" exception in RUPA

[48] *See* [Redacted] Memorandum of Points & Authorities in Support of Plaintiff's Motion for Partial Summary Judgment, etc., *In re Heller Ehrman*, No. 08-32514 DM (Adv. Pro. No. 10-03210) (Bankr. N.D. Cal. Aug. 1, 2013), ECF 196-1 at 20:21–21:16.

§ 16401(h) to hold as a matter of law that it is "reasonable" for those lawyers to retain all of their hourly fees.

It is more than "reasonable" for the former partners and their new firms to receive and retain their full, contractually agreed-upon hourly compensation if they are actually doing the client's work under the contract specifying that compensation. Unlike the dissolved firm, they are authorized to work on the matter at the contractual rate and have not been terminated from the matter. They should receive all of the agreed-upon compensation.

There is venerable precedent for this approach. In *Fracasse v. Brent*, this Court held that a lawyer terminated from a contingent matter before judgment has the right to a *quantum meruit* recovery for the "reasonable value of services rendered to the time of discharge." 6 Cal. 3d at 790. But the Court acknowledged that, under certain circumstances, a *quantum meruit* recovery could turn out to be equal to the contractually agreed-upon fee. For example: "To the extent that such discharge occurs 'on the courthouse steps,' where the client executes a settlement obtained after much work by the attorney, the factors involved in a determination of reasonableness would certainly justify a finding that the entire [contractual] fee was the reasonable share of the attorney's services." *Fracasse*, 6 Cal. 3d 791.

The Court's implicit rationale appears to have been that it is "reasonable" for a lawyer who has done everything that he promised to do to receive all of the compensation that the client promised to pay him. Likewise, a lawyer who is performing the client's work on an hourly basis to the apparent satisfaction of the client is doing everything that he promised to do and should receive all the compensation that the client promised to pay him. But that won't happen, and an *un*reasonable result will be reached, if the bulk of his profits must be shared with a defunct firm that can't do, and isn't doing, anything of value for the client.[49]

Accordingly, this Court should hold, as a matter of law, that where an attorney is currently serving a client under a fee agreement providing for hourly compensation, the lawyer should receive the full compensation specified in that agreement, and he or his law firm should retain that compensation in the face of any claim that they are engaged in the "winding up" a dissolved law firm's unfinished business.

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[49] Another bright-line valuation rule that California courts have applied in the *quantum meruit* context is that "the appropriate fee for the attorney is zero" where an ethical violation "pervades the whole relationship." *Fair v. Bakhtiari*, 195 Cal. App. 4th 1135, 1150 (2011); *see also id.* at 1161.

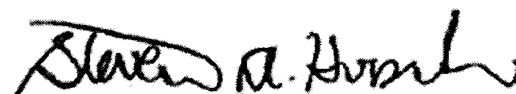
III. CONCLUSION

For all the reasons stated above, the Court should hold that under California law, a dissolved law firm has no interest in legal matters that are in progress but not completed at the time the law firm is dissolved, when that firm had been retained to handle the matters on an hourly basis.

Alternatively, the Court should hold as a matter of law that the "reasonable compensation" afforded to former partners for winding up the dissolved law firm's business under RUPA § 16401(h) equals the contractually negotiated hourly fee that the new firm is charging for performing that work.

Respectfully submitted,

Dated: February 2, 2017



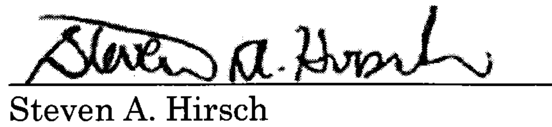
Steven A. Hirsch
Steven P. Ragland
KEKER, VAN NEST & PETERS LLP
Attorneys for Davis Wright Tremaine LLP
Defendant and Respondent

Peter P. Meringolo
Luther K. Orton
PMRK LAW, LLP
Attorneys for Foley & Lardner LLP
Defendant and Respondent

CERTIFICATE OF WORD COUNT

Pursuant to California Rules of Court 8.504(a), 8.504(d)(1) and 8.204(c))(1), and in reliance upon the word count feature of the software used, I certify that the attached Joint Answer Brief on the Merits contains 13,980 words, excluding parts not required to be counted under Rule 8.204(c)(3).

Dated: February 2, 2017



Steven A. Hirsch

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PROOF OF SERVICE

I am employed in the City and County of San Francisco, State of California in the office of a member of the bar of this court at whose direction the following service was made. I am over the age of eighteen years and not a party to the within action. My business address is Keker & Van Nest LLP, 633 Battery Street, San Francisco, CA 94111-1809.

On February 2, 2017, I served the following document(s):

ANSWER BRIEF OF DAVIS WRIGHT TREMAINE LLP AND FOLEY & LARDNER LLP

☑ by regular **UNITED STATES MAIL** by placing Copy in a sealed envelope addressed as shown below. I am readily familiar with the practice of Keker & Van Nest LLP for collection and processing of correspondence for mailing. According to that practice, items are deposited with the United States Postal Service at San Francisco, California on that same day with postage thereon fully prepaid. I am aware that, on motion of the party served, service is presumed invalid if the postal cancellation date or the postage meter date is more than one day after the date of deposit for mailing stated in this affidavit.

Christopher D. Sullivan
Matthew S. Sepuya
Diamond McCarthy LLP
150 California Street, Suite 2200
San Francisco, CA 94111

Jeffrey T. Makoff
Ellen Ruth Fenichel
Valley Makoff LLP
388 Market Street, Suite 1300
San Francisco, CA 94111

Kevin W. Coleman
Nuti Hart LLP
411 30th Street, Suite 408
Oakland, CA 94609-3311

Shay Dvoretzky
Jones Day
51 Louisiant Avenue, N.W.
Washington, DC 20001

Eric A. Shumsky
Orrick, Herrington & Sutcliffe LLP
Columbia Center
1152 15th Street, N.W.
Washington, DC 20005

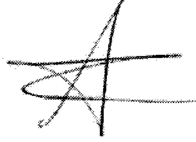
Rachel Wainer Apter
Christopher J. Cariello
Orrick, Herrington & Sutcliffe LLP
51 West 52nd Street
New York, NY 10019

Pamela Phillips
Jonathan W. Hughes
Arnold & Porter LLP
3 Embarcadero Center, 10th Floor
San Francisco, CA 94111

Hon. Richard R. Clifton, Hon. Sandra S. Ikuta, and Hon. Royce C. Lamberth
United State Court of Appeals
for the Ninth Circuit
95 7th Street
San Francisco, CA 94103

Executed on February 2, 2017, at San Francisco, California.

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



Laura Lind