Case No.: S236208

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

HELLER EHRMAN, LLP,

Plaintiff and Petitioner,

vs.

DAVIS WRIGHT TREMAINE LLP,

Defendant and Respondent.

AND RELATED CASES

SUPREME COURT
FILED

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QUESTION CERTIFIED BY THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

CASE NOS. 14-14314/14-16315/14-16317/14-16318

REPLY BRIEF

[*Caption Continued on Next Page*]

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INTRODUCTION

Invoking no less than "common sense," "basic math" and dystopian "chaos," Respondent large law firms[1] implore this Court to create a rule for how unfinished business is handled by dissolving large law firms that is different from all other California general partnerships, notwithstanding that the Legislature provided that all general partnerships are governed by the same rules. (Cal. Corp. Code § 16101(1).) The consistent flaw in Respondents' reasoning is that it confuses "the business of law" and "the practice of law." The business of law, as carried-out in a general partnership, is similar to other business partnerships. Partners join together in a common profit-seeking endeavor. They invest in a collective identity, infrastructure and business development. They divide their efforts. They work. They charge. They share profits, losses, assets and liabilities. They dissolve, and in some dissolutions they owe creditors money for debts that the partnership incurred in generating the business of the firm. The business of law has few unique financial characteristics, and the dissolution of a business that provides legal services proceeds essentially the same way as other businesses. In contrast, the "practice of law" is governed by certain principles that do not apply to other professions – which protect clients, and none of which protects a right of rainmaker partners who "control" client business to take that business to a new firm without compensating the

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[1] Heller will file one joint reply to the three brief are of Respondents. Defined terms used in the Opening Brief will be used in this Reply.

dissolving firm whose partners collectively incurred debts and made investments to develop that business.

Respondents also liberally confuse the California law issue before this Court and the federal law issues in the underlying actions.[2] The specific federal claims by Heller against Respondent law firms arises from the fact that the Respondent law firms received the profits from the unfinished business matters that are subject to a former Heller partner's duty to account to Heller as subsequent transferees without Heller receiving reasonably equivalent value in return for the loss of its right to the profits. The issue certified to this Court concerns the duty to account under California law. The purported "waiver" of that duty by Heller's partners, after it was insolvent, creates a claim by creditors under federal bankruptcy law that is beyond the subject matter jurisdiction of this Court.

Over 150 years of general partnership dissolutions show that the partner's duty to account for unfinished business is a workable rule with none of the catastrophes argued by Respondents. A simple way for law firm partners to avoid problems is for the partners to execute "*Jewel* waivers" before the law firm becomes insolvent (*Jewel v. Boxer* (1984) 156 Cal.App.3d 171, 178-80) or to agree in advance on a formula for dividing the revenues from unfinished business with the partnership. A fraudulent conveyance issue does not exist when a partnership right is waived by a solvent firm.

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[2] The DWT/Foley Brief seeks to restate the issue before the Court as encompassing whether a claim exists "under federal bankruptcy law", an issue that is for the federal courts to decide. (See, e.g., *MSR Exploration, Ltd. v. Meridian Oil, Inc.* (9th Cir 1996) 74 F.3d 910, 915.) Heller presumes the Court will stick with the issue it certified.

Fraudulent conveyance arises only when a firm without a Jewel waiver incurs million dollars in debt, but executes "*Jewel* waivers" on the eve of dissolution when the firm is insolvent.

The partners of an insolvent firm should not simply hand over the profits to whatever firm that can lure a single departing partner to bring the work. The partners in troubled law firms have a fiduciary duty to complete the business of the dissolving firm and account for the profits earned. Not only is the waiver of such a right inequitable to creditors – who are the parties that the Legislature is primarily protecting under Corporations Code section 16807(a) -- it also permits a subset of partners who control client work to capture future profits for themselves. A *Jewel* waiver when a law partnership is insolvent disregards entirely the interests of the unpaid creditors of a failed law firm – the secretaries, associates, retired partners, and others – and the importance of collecting the assets of the partnership to pay the debts to its creditors. In a true general partnership, it also could leave "non-rainmaker" partners holding the bag for the full amount of personal liability to creditors.[3]

Respondents are large law firms with complex partner compensation structures. To the extent there is any complexity in large law firm partner unfinished business accountings, the Legislature by its actions and inactions has determined that the burden is less than the benefits of the rule.

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[3] The simple, clear and longstanding goal of Corporations Code section 16807 is that, in dissolution, general partnership creditors are paid first, followed by all partners per their agreement.

The Unfinished Business Rule is based upon economic and fairness principles that have withstood the test of time, as applied to all kinds of businesses for all of California legal history (first by case law, then statute). The economic principle is that the Unfinished Business Rule allows the partnership itself to retain the benefits of years of partnership investment and risk put into developing its business. The fairness principle is that the enforcement of the fiduciary duty to account for the profits from completing the partnership's unfinished business benefits all the partners in the dissolving firm equally and provides an important source of revenue to pay debts owed to creditors by the partnership.

The cases before the Court do not involve a situation in which a client "fired" Heller and retained a different, non-Heller, lawyer – i.e. in which the partnership lost an asset in competition with a third-party. These cases exclusively involve circumstances in which a Heller partner (or small subset of partners) who controlled a case transported that case – and its accompanying profit stream – to a new firm through private negotiations that did not consider the investments by Heller which placed that partner in control of that work.

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ARGUMENT

I. RESPONDENTS IGNORE THE LANGUAGE, PURPOSE AND POLICIES OF THE DIRECTLY-APPLICABLE CALIFORNIA CORPORATIONS CODE SECTIONS.

A. When A Partnership Dissolves, The Corporations Code's Provision That Each Partner Must Account For Any "Property, Profit or Benefit" Establishes a Property Right.

California Corporations Code section 16404(b)(1) obligates each partner of a dissolving partnership "[t]o account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct or winding up of the partnership business . . . " No partner is entitled to any compensation for completing partnership business, except for reasonable compensation for services rendered in winding up the business of a partnership. (Cal. Corp. Code §16401(h).) As outlined in Heller's Opening Brief ("OB") at 42 – 46, the well-recognized right of a dissolving partnership to the profits earned by its partners from completing the unfinished business of the partnership gives rise to a cause of action and establishes an enforceable property right under California law.

Respondents rely on the client's right to terminate a lawyer without cause and other aspects of the rights and obligations between lawyers and clients to argue that the right of a law partnership to recover the profits from completing the unfinished business from the partners should not be recognized as a property right. The rights and obligations of a law partnership and its partners, however, are not

governed by the rights and obligations that apply to lawyers and clients.

Thus, for example, as held in the cases in the OB at 43, a law partnership can protect its contractual rights with respect to its ongoing business matters as against third parties who intentionally interfere with an attorney-client engagement agreement even though the relationship is at will. Orrick notes this rule in a footnote (Orrick Answering Brief ["AB"] at 18), citing *Frazier, Dame, Doherty, Parrish & Hanawalt v. Boccardo, Blum, Lull, Niland, Teerlingk & Bell* (1977) 70 Cal.App.3d 331, 337-38, but gives short shrift to the impact of the rule and case itself. In fact, the *Frazier* case relied on a California Supreme Court case, *Herron v. State Farm Mutual Insurance Co.* (1961) 56 Cal.2d 202, 205, to note that, "Contractual relations between attorneys and their clients are entitled to the same protection afforded other business relations." (70 Cal.App.3d at 337-38.)

A law partnership's contractual rights in its attorney-client engagement agreements (and its ongoing business matters) are not completely swept away by the limits of its rights against the clients. Indeed, following the Respondents' arguments would lead to extreme and unjustified results. It would effectively prevent any lawyer or law firm from collecting profits earned by another law firm even where there was an intentional breach of fiduciary duty by the firm's partner that led to the client moving the matter to the new firm. In such a circumstance, the imposition of a constructive trust over proceeds wrongfully obtained in breach of fiduciary duty certainly would be proper. *See Warren v. Merrill* (2006) 143 Cal.App.4th 96 (party

entitled to constructive trust as remedy for breach of fiduciary duty); *Lund v. Albrecht* (9th Cir. 1991) 936 F.2d 459, 464 (same). The law firm has a property right in its contractual relations with its clients and is entitled to recover any profits improperly captured by a partner in breach of her fiduciary duties. The partnership's rights against its partners are distinct from its rights against its clients.

What governs is the broad statutory language defining what is partnership "property," outlined in Heller's OB at 15-17, as recognized by the California case law that has consistently applied the Unfinished Business Rule.

B. Unfinished Business Is A Partnership Asset In Recognition of the Fiduciary Duties of Partners Because It Is The Product Of Partnership Investments And Has Financial Benefits That Survive The Partnership's Decision to Dissolve.

Respondents seek to shift the issue from whether a partnership's claim to the profits from unfinished business is property to whether "clients" are property of the firm. This is an example of confusing "the business of law" and "the practice of law." A law firm's book of business is an asset of the firm, developed from investments in personnel, facilities, and business development and branding. It is an asset on which creditors lend money or rely upon in continuing to do business with the firm. When a partner leaves, her ability to transport that business is a factor in her future placement. In "the practice of law," each client may decide which partners to hire and which to retain. The fact that clients make decisions does not make it any less true that law partners make collective investments to

attract and retain cases in a book of business: "the case" belongs to the client, but the business of working on the case belongs to the law firm that attracted the case over other law firms.

Respondents sidestep two critical attributes of the fiduciary duties of law partners that apply to the unfinished business. First, the partners of a dissolved firm have a ***duty*** to "complete the business of the dissolved partnership existing prior to its dissolution (unfinished business)." (*Rosenfeld, Meyer & Susman v. Cohen* (1986) 146 Cal. App. 3d 200, 216, disapproved on other grounds by *Applied Equip. Corp. v. Litton Saudi Arabia Ltd.* (1994) 7 Cal. 4th 503.)[4]

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

Stated simply, a dissolving law firm has an interest in the future profit stream attributable to all business matters pending at the time of dissolution because the partner completing that work gained her position in the case through his partnership at Heller. Every piece of

[4] See also *Jewel v. Boxer* (1984) 156 Cal. App. 3d 171, 179 ("[E]ach former partner has a duty to wind up and complete the unfinished business of the dissolved partnership."); *Little v. Caldwell* (1894) 101 Cal. 553, 560 ("[T]he survivor [partner] is bound to complete the unfinished contract for the benefit of the partnership.")

business that is the subject of Heller's action is a matter that (1) was attracted to Heller through the collective investments and efforts of the partnership, and (2) was taken by a single Heller partner or subset of partners directly to another firm – which made absolutely no corresponding investment in attracting that client relationship.

These cases do not involve situations in which Heller "fired" its clients by telling a client to go to a non-Heller lawyer. These cases also do not involve situations in which Heller's clients "fired" Heller by choosing a lawyer who was not affiliated with Heller. Nor do these cases involve situations in which the client "chose" to go with a different law firms after the dissolution, independent of the involvement of a former Heller partner. Heller makes no claim against firms who did not gain business by hiring a former partner who could bring the business directly from Heller.

These cases solely address situations in which a Heller partner transferred an ongoing Heller case directly from Heller to a new law firm – i.e. took advantage of his or her ongoing position on the case, gained at Heller with all of the costly resources that Heller invested in to make itself attractive to clients.

So every time Respondents argue that these cases involve work done "by someone else", the Court should understand that: (1) Heller's investments created the client relationship, (2) the only reason the new firm is in a position to complete that work is because a former Heller partner brought the case to the new firm without compensating Heller (or its creditors) for Heller's investment in forming that client relationship, and (3) the new firm has made no

comparable investment in acquiring the client to justify its retention of profits over and above reasonable compensation.

The Unfinished Business Rule has existed for as long as it has, originally a creature of equity and now statute, because it is the fair way to dissolve a partnership.

C. Changes to RUPA Did Not Abrogate The Unfinished Business Rule, Rather It Was Refined By Including a "Reasonable Compensation" Allowance.

Respondents greatly exaggerate and misinterpret the significance of RUPA's addition to California Corporations Code section 16401(h) to allow for reasonable compensation, and other changes to RUPA, in arguing that the revisions somehow impliedly overruled the Unfinished Business Rule. First, as outlined in the OB at 31 – 32, there is no express indication of such an intent by the Legislature. To the contrary, the provision allowing for "reasonable compensation" serves to support the application of the rule by tempering the impact of the former "no compensation rule" on the partners of the dissolving firms and their subsequent firms.

Second, Respondents combine an invented and incorrect legal standard with an unsupported factual argument in contending that after the enactment of RUPA, a pre-RUPA case (*Jacobson v. Wikholm* (1946) 29 Cal. 2d 24), bars Heller from recovering the profits earned from completing the unfinished business. Respondents assert that RUPA sub silentio now requires that (1) the profits that must be held in trust means only "profits attributable to partnership capital" and (2) "reasonable compensation" means only profits "attributable to the

partner's own skill and labor." The interpretation is contrary to RUPA's express language. Section 16404(b)(1) requires an accounting to the dissolving partnership for any "profit . . . derived by the partner in . . . winding up of the partnership business," while Section 16401(h) states that a partner "is not entitled to remuneration for services performed for the partnership, except for the reasonable compensation." Reconciling the meaning of the provisions is straightforward: there is a right to "all profits derived" from completing unfinished business, but "reasonable compensation" may be deducted from such profits.[5] Profits are expressly distinct from reasonable compensation. Statutory provisions are to be interpreted so as to avoid, not create, contradictions. (See *Khajavi v. Feather River Anesthesia Medical Group*, (2001) 84 Cal. App. 4th 32, 46.) "It is a well-recognized principle of statute construction that when the Legislature has carefully employed a term in one place and has excluded it in another, it should not be implied where excluded." (*Ford Motor Co. v. County of Tulare* (1983) 145 Cal. App. 3d 688, 691. If the terms "profits" and "reasonable compensation" are interchangeable, different terms would not be used.

Respondents misconstrue *Jacobson*'s holding and significance. The decision reflected the limitation in UPA on the heirs of a

[5] *See* 9 E.B. Witkin, *Summary of California Law, Partnership* §47 at 623 (10th ed. 2005) ("A partner rendering sevices in winding up the partnership business is entitled to reasonable compensation . . . However, post-dissolution income generated through winding up of unfinished partnership business is allocated to the former partners according to their respective interests.").

deceased partner's rights to "continued" partnership's profits.[6] No bright-line rule was announced as to what constituted reasonable compensation. To the contrary, the court remanded for consideration the "15 offers of proof" the surviving partner offered surrounding the factual issues raised.

Developing the unfinished business pending at Heller's dissolution *was attributable* to the use of the firm's capital and the investments of the Heller partnership. As noted by this Court in *Howard v. Babcock* (1993) 6 Cal. 4th 409, 420, a "firm's capital finances the development of a clientele and the support services and training necessary to satisfactorily represent the clientele."

Respondents fare no better in arguing that the addition of a limitation in Corporations Code section 16404(b)(3) to "refrain from competing" with a firm in dissolution by its own terms can be read to overrule the "duty to account" for profits derived by a partner in the winding up of partnership business in Section 16404(b)(1). Respondents cite to no court decision in suggesting that the additional language in Section 16403(b)(3) overruled established California case law and was meant to render a nullity the provisions of its companion subsection, which is within a section (Section 16404) that is meant to be read as a whole.

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[6] Under the UPA, retired partners or heirs of deceased partners in "continuing" partnerships only had (a) a right to their partnership interest at the time of dissolution and (b) either interest on that value, or in lieu of interest, "the profits attributable to the use of his right in the property of the dissolved partnership." Cal. Corp. Code § 15042 (repealed). No such "attributable to" language exists in RUPA.

D. No Statutory Language Or Economic Reality Permits "Hourly" and "Contingent Fee" Cases To Be Treated Differently For Purposes Of Partnership Dissolution Economics.

Respondents attempt to distinguish the property and contractual rights of a law partnership in contingency cases (i.e., the rights of a dissolving law firm to the profits from contingency fee cases earned by it partners after the decision to dissolve) from the property and contractual rights of a law firm in its hourly rate unfinished business matters. It is significant that Respondents acknowledge a "risk of confiscation" exists with respect to contingency matters "[u]nless the firm is granted some sort of remedy" to collect the profits from the unfinished contingency matters taken by its partners. (E.g., DWT AB at 30.)

There is no basis in the governing statutory framework; the case law from which the statutory framework evolved or interpreting the governing statutes; or economic fairness that justifies the Respondents' proposed distinction. Prior to dissolution a partnership's interest in the profits earned from contingency, blended fee arrangement, and pure hourly matters, of course, are equivalent. The partnership is entitled to such profits because they reflect the realization of investments and work performed by the individual partners on behalf of the partnership. The same is true for the unfinished contingency, blended fee arrangement, and hourly matters completed as part of winding up the partnership's business.

This reality was recognized by the Court of Appeals in *Rothman v. Dolan* (1993) 20 Cal.App.4th 755, 759, when it held that

"unfinished business simply consists of all matters in progress which have not been completed at the time the firm is dissolved. (*Freese v. Smith* (1952) 114 Cal.App.2d 283, 289 [].) That one matter is to be compensated at an hourly rate and another on a contingency is of no consequence in determining whether a matter is unfinished business." The *Rothman* court properly recognized that "each partner has a fiduciary duty to the other partners to complete the unfinished business of the partnership." (*Id.* at 758.) The work is to be completed for the benefit of the dissolving partnership. It would be "fundamentally unfair" to apply a "different treatment of the unfinished business of the parties' clients on the basis of the form of compensation." (*Id.* at 759.)

The *Rothman* court properly relied upon a partnership case, not involving law partnerships, *Freese v. Smith* (1952) 114 Cal.App.2d 283, 288-90, which reviewed the long-standing "general rules and principles governing dissolutions" in holding that all profits from unfinished business existing as of the date of the decision to dissolve belonged to the dissolving firm. In turn, the *Freese* court relied on two California Supreme Court cases, which squarely held that (a) "a dissolution operates only with respect to future transactions; as to everything past the partnership continues until all pre-existing matters are terminated" (*Cotton v. Perishable Air Conditioners* (1941) 18 Cal. 2d 575, 577) and thus, (b) "the partnership character of the property continued until the interest of the partnership was terminated." (*McNeny v. Touchstone* (1936) 7 Cal.2d 429, 437.) (114 Cal.App.2d 283, 289.) As a result, profits earned from completing the pre-

existing matters are owed to the dissolving partnership. (114 Cal.App.2d at 289-90.)

In *Robinson v. Nussbaum* (D.D.C. 1997) 11 F. Supp. 2d 1, 3, a D.C. federal district court considered under District of Columbia law "whether profits earned by [the dissolving D.C. law firm's] former partners on matters pending at the firm at the time of dissolution billed not [on a] contingency basis but on an hourly rate basis, are 'property' under the Partnership Act." The court began by noting general partnership rules that apply equally under California law: "following the dissolution of a law partnership, the pending cases are 'uncompleted transactions' under the Partnership Act and require winding up." (*Id.* at 4.) These pending cases, as properly recognized by the court, "remain 'assets' of the partnership." (*Id.)* The court noted "that 'all work performed on partnership business unfinished at the date of dissolution . . . was done for the benefit of the dissolved partnership. [citation].'" (*Id.*) The court further held, as a matter of D.C. law, that "how the firm's clients were billed, either at an hourly rate or on a contingency fee basis, does not change the status of their work as partnership property." (*Id.* at 5.) As the *Robinson* court concluded, "there is no relevant distinction between hourly rate and contingent fee representation" and "simply no basis for carving out a separate rule for profits earned from work on hourly rate matters pending at the time of dissolution." (*Id.*)

The court in *Robinson* also "seriously considered" whether the result was unfair. (*Id.* at 6.) For several reasons, the court determined

it was not. First, law firms are free in advance of dissolution[7] to write partnership agreements that "provide for an exact distribution of profits from hourly rate matters after dissolution." (*Id.*) Second, the unfinished business rule "applies only to matters pending at the firm at the time of its dissolution" and does not apply "to new matters for clients of the dissolved firm." (*Id.*) The former partners thus stand to gain tremendously when they are able to move clients from the dissolving firm to their new firm. Third, the rule should be applied equally to all unfinished matters partners from the dissolved firm take to their new firm. Requiring all partners to honor their duty to account for the unfinished business profits best serves the fiduciary duty partners owe to the partnership and to each other. (See *id.*) Though the *Robinson* court was a federal district court applying a different state law, its reasoning is persuasive and the holding, consistent with *Rothman,* should be followed by this Court.

Law firms employ a wide variety of engagement agreements when handling diverse client matters. For example, in addition to standard or discounted hourly rate terms, firms routinely offer fixed fee arrangements, discounted rates with performance bonus incentives, blended hourly and contingency engagements, and pure contingency fee agreements. These varying agreements all reflect the partnership's joint efforts and commitment to invest in multiple undertakings that bear fruit through future profits that differ in magnitude, that may or may not be immediately realized, and which may not even materialize at all. What the agreements all share in

7 Of course, if such a provision is added when a firm is insolvent then it may be subject to avoidance under federal fraudulent transfer law.

common is that the partnership that secured the business is entitled to the profits, if any, earned from the partnership's investments and efforts. When a partnership faces dissolution, its interests in realizing the profits from all such unfinished matters earned as part of the dissolving firm's winding up must be accounted for as set forth in the governing statutory framework. California Corporations Code section 16401(b)(1) by its terms requires each partner of a dissolving firm to account for any property, profit, or benefit derived from winding up the partnership's business. The Respondents' attempt to exempt the profits from hourly matters is unjustified and, in any event, must be rejected in favor of the clear statutory language.

E. Completing the Firm's Unfinished Business Is A Critical Duty Undertaken By Its Partners For the Benefit of the Dissolving Partnership.

Orrick makes the novel argument that the partners of a dissolving firm that complete the partnership's unfinished business matters do not undertake this work as part of the firm's winding up process. (Orrick AB at 24 – 30.) Orrick ignores more than 150 years of established California case law, codified in the UPA and RUPA, consistently holding that the completion of unfinished business matters existing on the date of dissolution is part of the winding up process for the partnership.

Orrick acknowledges that winding up "means discharging the partnership's obligations to others" and "safeguarding and distributing existing value." (Orrick AB at 29.) The winding up of a dissolving partnership imposes fiduciary duties on the partners to attempt to

maximize the value that is realized from the assets. (See generally, *Everest Investors 8 v. McNeil Partners* (2003) 114 Cal.App.4th 411, 424-25 [general partner's fiduciary duty to limited partners encompasses the obligation to maximize return to limited partners in merger transaction, and noting that a partner's fiduciary extends into dissolution]; *In re Marriage of Munguia*, (1983) 146 Cal.App.3d 853, ___ (divorcing spouse managing a business constituting a community property asset has a fiduciary duty to maximize the value of the business by attempting to secure a lease for its continued operation). The partners' fiduciary duties to the dissolving firm include the protection of profits that can be realized from completing a partnership's hourly unfinished business matters. This imposes upon partners a duty to complete the unfinished business for the benefit of the partnership, not to simply give away the profits subsequently earned by those partners as they fulfill this duty to the dissolving partnership. (See *Dickson, Carlson v. Pole* (2000) 83 Cal.App.4th 436, 445 [holding that partners have a duty to *complete* unfinished business not merely transfer it to another firm].)

F. The *Thelen* Case Was Based Upon Different Partnership Laws, Non-California Case Law, And Made No Attempt To Reconcile Ethical Rules That Protect Clients And Unambiguous Partnership Laws That Protect Creditors And General Partners.

Respondents continue in this Court their efforts to replace California law with New York law by urging that the New York Court of Appeals decision in *In re Thelen LLP* (2014) 242 N.Y.3d 16, be

followed here. As outlined in the OB at 38-42, the decision under New York law and following a different partnership statutory regime, conflicts with California's long-standing recognition of the strong fiduciary duties that partners owe to each other and the partnership as embodied in the Unfinished Business Rule and California's codification of its governing partnership framework.

Respondents do not address the contrary decision of the Colorado Supreme Court in *LaFond v. Sweeney* (Colo. 2015) 343 P.3d 939, 944, which declined to follow *In re Thelen* and instead agreed with the "majority of jurisdictions that have followed *Jewel* in concluding that pending contingency cases are the unfinished business of a law firm; therefore any profit derived from such cases belongs to the law firm and not to an individual partner." While the decision in *LaFond* also is based on a different state's law, it was decided under RUPA and a partnership statutory provision that allowed for reasonable compensation. (*Id.* at 949-50) More importantly, the focus of the *LaFond* court "upon (1) the principle that law firms do not end upon dissolution but extend through the winding up and (2) the fiduciary duties" of law partners (in *LaFond* members and managers of an LLC) that continue during the period (*id.* at 945), comports far better with California's application of these principles in the context of partnership dissolutions. Although the dispute before the Colorado Supreme Court involved a contingency fee agreement, the court's recognition of the importance of the "[f]iduciary duties [that] continue to apply through the winding up process" (*id.* at 946) should apply equally to hourly fee arrangements.

Similarly, the Colorado Supreme Court's conclusion that the Unfinished Business Rule does not violate a "client's unfettered right to counsel" (*id.* at 947-48) is much more in line with California's case law and the correct conclusion. As the court stated, "Hypothetical harm, as opposed to actual harm to the client's ability to choose counsel in the case, is not a pertinent consideration when determining the rights and obligations of attorneys to their firms." (*Id.* at 947) When the partners of a dissolving firm are completing the unfinished business they are doing "what they are professionally obligated to do" and honoring their fiduciary duties to complete the business on behalf of the dissolving firm. (*Id.* at 946.) "An attorney does not have an unfettered right to withdraw from representation due to financial concerns." (*Id.* at 947-48.) The winding up of a dissolving partnership imposes fiduciary duties on the partners to attempt to maximize the value that is realized from the assets. While *LaFond* is decided under different state law and involved a contingent representation, the decision is persuasive in rejecting the purported policy arguments offered by the *Thelen* court and advanced by Respondents here.

At bottom, the court in *Thelen* elevated *a client's right* to discharge an attorney over the *partnership's* independent contractual rights and interests in the profits from the engagement and the *partner's* fiduciary rights and obligations. While the client's rights take precedence over the rights of the partnership if there is a dispute between the client and the partnership, the client's rights do not govern the determination of the rights and obligations of the partners and the partnership inter se. As also discussed further below, the

proffered professional ethics concerns and policy justifications are insufficient to disregard the express statutory provisions enacted by the California legislature. Even if this Court were to treat the issue as an undecided matter of common law, and not one of statutory interpretation, the policy concerns support continued application of the Unfinished Business Rule over the contrary result in *Thelen*.

II. RESPONDENTS VARIOUS "ETHICAL" AND "POLICY" ARGUMENTS HAVE NO VALID FACTUAL OR EQUITABLE UNDERPINNING.

A. These Cases Involve Circumstances Where Clients Followed A Former Heller Partner In Moving the Work To New Firms and Do Not Involve Clients Being "Fired."

Respondents go to great lengths to try to cast these cases as involving a situation where Heller "fired" its clients. It is telling that Respondents stretch so far in an effort to dodge the fiduciary duties the partners undeniably owed to the dissolving partnership. The practical reality cannot be reconciled with the assertion that clients unilaterally moved the cases to independent firms because Heller fired them as clients. The practical reality is that the clients followed Heller's former partners to their new firms based on the existing relationship in place at the time of dissolution.

Simple logic dictates that clients hired the successor firms because the Heller lawyers handling their cases moved to those firms. (The Respondents' contention that the clients hired them because of their unique capabilities and that the presence of Heller lawyers was merely incidental to that decision is self-serving

speculation. If the successor firms were so attractive to clients on their own, it begs the question of why the clients retained Heller rather than Respondents' in the first place.)

Respondents' suggestion that Heller could simply "fire" its clients is misguided. A dissolving firm is bound by the well-established duties applying both to the lawyers working on the case and the firm as a whole "to continue to serve the client unless withdrawal is permitted by the provisions of rule 3-700." (Cal. State Bar Standing Comm. on Prof'l Responsibility & Conduct, Formal Op. 2014-190.) As the California State Bar opinion illustrates, partners working on a client's case generally develop critical knowledge of importance to the client. (*Id.*) The partners of a dissolving firm are clearly are a step ahead in asking the firm's clients to move with them to new firms and are often indispensable.

The substance is what counts, not the characterization that Respondents now offer to describe how and why the clients moved from Heller. Respondents' contentions are similar to claims that have been made repeatedly to California courts, and rejected consistently, that simply because a client enters into a new engagement agreement the former partnership's right to the profits from an unfinished business matter is cut off. An unbroken line of California cases have rebuffed this argument, starting with the Court in *Little v. Caldwell* (1894) 101 Cal. 553, 560-62 (surviving partner could make "new or substituted contract" with firm clients but it would not result in "an entire extinguishment of the original contract" nor result in the "den[ial] [of] the right of the representatives of the deceased partner to an equitable participation in the profits realized from the latter

contract"). California appellate courts have cited *Little* with approval on this exact issue. (See, e.g., *Rosenfeld, Meyer & Susman v. Cohen* (1983) 146 Cal. App. 3d 200, 219 [("It is clear that a partner completing unfinished business cannot cut off the rights of the other partners in the dissolved partnership by the tactic of entering into a 'new' contract to complete such business."]; *Jewel v. Boxer* (1984) 156 Cal.App.3d 171, 178 [explaining "a client's retention of a new firm . . . did not transform the case into new partnership business"].)[8]

The courts in *Little*, *Rosenfeld*, and *Jewel* squarely held that a new retention agreement does not impact the Unfinished Business Rule. These courts properly recognize that public policy would be greatly undermined if partners could evade their fiduciary duties by merely having the client in the unfinished business matter sign a new retainer agreement with the partner's new firm. In a similar vein, if partners of a firm could simply declare that they are firing their clients when they vote to dissolve as a way to avoid the Unfinished Business Rule, it would permit the partners to violate their fiduciary duties to the partnership. Indeed, if the tactic of declaring that the dissolving firm is "firing" its clients is sufficient to allow the partners to avoid having to account back to the dissolving partnership for the profits from the unfinished business, the tactic would just be a form of *Jewel* waiver in sheep's clothing.

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8 Courts in other UPA and RUPA jurisdictions agree that a partnership's right to unfinished business is not extinguished by partners entering into new contracts or new forms of incorporation. *Ruby v. Abington Mem. Hosp.* (Pa. Super. Ct. 2012) 50 A.3d 128, 132-34.

B. Lawyer Mobility Is Not Hurt One Iota By The Unfinished Business Rule.

In page-after-page of briefing on "lawyer mobility", Respondents do not cite a single study, survey, article or authority of any kind to show that a California lawyer who brings cases from major corporate clients has ever had any problem finding a new position. The Unfinished Business Rule has been the law in California for over a century. There is a highly-visible, veritable raging river, of lawyer mobility in California – perpetual partner migration. If there ever becomes a concern that a lack of lawyer mobility is harming the public (or lawyers), it is the Legislature's function to investigate the issue and balance mobility against, e.g., a firm's ability to obtain credit if dissolving partners are allowed to grab for themselves and their new firm's matters that were acquired through debt-financed office leases and rainmaker bonuses. It is not this Court's role to make fact findings on "lawyer mobility" without competent evidence, or to determine whether the Unfinished Business Rule is worth any costs that it may impose upon legal and other professions.

There is no evidence the Legislature was the least concerned about lawyer mobility when it applied the general partnership dissolution provisions fully and without exception to law firms. It is insufficient for Respondents simply to declare, without any support, that lawyer mobility will be harmed. This is not a subject of which judicial notice can be taken or on which the Court should define policy. (See *Am. Bank & Trust Co. v. Cmty. Hosp.* (1984) 36 Cal. 3d 359, 372 ["It is not the judiciary's function . . . to reweigh the 'legislative facts' underlying a legislative enactment"]; *Bonnell v.*

Med. Bd. of California (2003) 31 Cal. 4th 1255, 1263 [in construing a statute "it is not [the Court's] function to 'inquire into the wisdom of underlying policy choices . . . [the] task here is confined to statutory construction"]; *Green v. Ralee Eng'g Co.* (1998) 19 Cal. 4th 66, 71 ["[A]side from constitutional policy, the Legislature, and not the courts, is vested with the responsibility to declare the public policy of the state."]; *Warden v. State Bar* (1999) 21 Cal. 4th 628, 650 ("'[T]he absence of 'legislative facts' explaining the distinction [o]n the record has no significance . . . a legislative choice is not subject to courtroom factfinding'."); *McKell v. Washington Mut., Inc.* (2006) 142 Cal.App.4th 1457 ["Where a UCL action would drag a court of equity into an area of complex economic policy, equitable abstention is appropriate. In such cases, it is primarily a legislative and not a judicial function to determine the best economic policy."].

C. DWT's "No-Work, No-Pay" Argument Ignores The Characteristics Of Business Ownership.

In response to Heller's detailed analysis of California partnership law, both statutory and interpretive, DWT asks the Court to rule that this case is controlled by a "ubiquitous and seemingly obvious no-work, no-pay principle." (DWT AB at 18.) While a general concept of "no-work, no-pay" may define the relationship between employees and their employers, or lawyers and their clients, it does not define the rights between business owners (or business owners and their creditors). The benefits and risks of partners and others who co-own a business are not directly based on doing the "work." A rainmaker may be the laziest "worker" in the firm – but

the highest paid due to client relationships that bring in business. A high-billing partner may be the lowest paid, because she has no clients and no bargaining power. In a true general partnership, all of these partners can be personally and fully liable when a law firm dissolves and it is time to pay back creditors for investments that made it possible for the high paid "finder" partners to bring in cases for the "grinder" partners to earn their wages. When a finder carries a case brought in through a dissolving firm's joint investments to a new firm, *and generates more than reasonable compensation for it*, the Unfinished Business Rule recognizes that the dissolving partnership's joint investments put her in that position and that the partnership deserves to be compensated for the partnership's investments and collective efforts.

Contrary to DWT's argument, California partnership law specifically provides a former partner with "reasonable compensation" for all work required to complete unfinished business. (Cal. Corp. Code § 16401(h).) What must be accounted for to the dissolving partnership is any property, profit or benefit that the departing partner gains from the unfinished business that exceeds reasonable compensation. (Cal. Corp. Code § 16404(b)(1).) That property, profit or benefit is treated by statute as a partnership asset, which must be devoted first to pay partnership creditors and, once those obligations are fulfilled, shared by all partners who placed the work controlling partner in control.

Not one case cited by DWT concerns a claim to assets, profits or benefits between business owners as to business acquired through collective partnership investments. In various irrelevant contexts,

DWT's cases address an entitlement to compensation.[9] Heller readily agrees that compensation is guaranteed by California law to partners who are involved in completing unfinished business -- through RUPA's express provision for reasonable compensation.

D. The Court Should Be Cautious To Separate The Certified Issue Of California Law From The Impact Of Federal Law Bankruptcy Law On The Events In This Case.

This Court certified a pure state law question turning on California partnership law. (Order Granting Request to Decide Question of State Law, Aug. 31, 2016.) The state law question before this Court involves the rights and obligations of partners to each other and to the partnership. These are determined by considering the provisions in RUPA and the California case law.

Respondents invite this Court to rewrite California law governing the relations between partners based on the argument that it is unfair for third party firms to be liable for receiving unfinished business profits. (See Jones Day AB at 16 – 35, 41 – 47; DWT AB at 5 – 37, 53 – 59, Orrick AB at 31 – 46.)

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9 See DWT AB at 15, n.19 & 16 citing *Gonzalez v. Downtown LA Motors, LP* (2013) 215 Cal.App.4th 36 (employees are entitled by law to be paid minimum wage for their work); *Laffitte v. Robert Half Int'l Inc.* (2016) 1 Cal. 5th 480 (determining compensation for class action attorneys begins with an analysis of hours worked); *Flannery v. Prentice*, 26 Cal. 4th 572 (2001) (addressing method of calculating attorneys' fees for class counsel, which begins with an analysis of hours worked); *Champion v. Superior Court* (1988) 201 Cal. App. 3d 777 (attorney's fee is unconscionable if it bears no relation to the amount of service provided).

As noted in the OB at 37 – 38, the liability of third party law firms arises in the cases before this Court as a result of federal fraudulent transfer law and the remedies available against subsequent transferees pursuant to 11 U.S.C. section 550(a)(2) or as the entity "for whose benefit the transfer was made" in accordance with 11 U.S.C. section 550(a)(1). Such issues undeniably are federal questions that must be left to the federal courts. (E.g., *Butner v. United States* (1979) 440 U.S. 48, 55 & n. 9 [describing that while the Congressional power to establish uniform laws over bankruptcy, as it has exercised with respect to federal fraudulent transfer laws, is supreme over conflicting state law, federal courts look to state law to determine property interests of the debtor]; *MSR Expl., Ltd. v. Meridian Oil, Inc.* (9th Cir. 1996) 74 F.3d 910, 915 ["the unique, historical, and even constitutional need for uniformity in the administration of the bankruptcy laws is another indication that Congress wished to leave the regulation of parties before the bankruptcy court in the hands of the federal courts alone"].)

The many state court decisions in both California and other states that address the rights of law partnerships and partners, and other partnerships and partners, when the partnership is dissolved illustrate that disputes between partnerships and the partners are far more common than cases involving claims against subsequent transferees that arise out of federal bankruptcy proceedings. While such claims are of great importance to the creditors of bankrupt law firms, the implications of federal bankruptcy law should be separated from the questions arising under state partnership law.

III. RESPONDENTS' VARIOUS OTHER "PRACTICAL"ARGUMENTS ARE BASELESS.

A. The Absence – Not Presence – Of An Unfinished Business Rule Will Create "Disorganized Law Firm Breakups."

Respondents law firms like to cite the statement in the New York *Thelen* case that leaving the Unfinished Business Rule in place will result in a "race to the exits" at the first sign of trouble. The contention assumes that partners will not behave like partners, who are obligated to act in the best interests of the firm. As DWT notes, the California State Bar recognizes that partners in a law firm facing dissolution have ethical and fiduciary duties "to work together towards an orderly dissolution." (Cal. State Bar Standing Comm. on Prof'l Responsibility & Conduct, Formal Op. 2014-190). And because experience shows that *Jewel* creates no disadvantage to a partner's ability to relocate after dissolution, the fear of a "race to the exits" is more theoretical than real.

Moreover, recognition of the rights of a law partnership (and other partnerships) to recover the profits from unfinished business matters in the context of partnership dissolution will protect those rights in the pre-dissolution context as well. As noted above (*supra* at 6-7), adopting the Respondents' arguments that because clients are not property of a law partnership there is no protectable property interest in the future profits from the firm's ongoing contractual relationships with its clients would leave partnerships without a remedy even in situations where there is an established fiduciary duty and a partner

interferes with those contractual relationships and grabs the client's business from the firm in breach of such duties.

Recognition of the partnership's contractual interests and property rights in protecting its interests in the firm's on-going client matters and the profits earned in working on such matters confirms a critical right of partnerships. Indeed, the partnership's interest in its client engagements is a predominant feature of law partnership agreements. For example, Heller's partners specifically agreed through its Partnership Agreement that "[a]ll clients for whom any Partners or Member does work shall be clients of the partnership." (DWT ER 130, ¶ 4.5.) The partners are bound by established fiduciary duties from absconding with the partnership's unfinished matters before the firm dissolves. Moreover, most firms' partner agreements contain at least 60 day notice and waiting periods, which provide further protection against a "race to the exits."

Finally, as has been recognized repeatedly by the courts that apply the Unfinished Business Rule, requiring all partners of the dissolving partnership to account for the profits for completing the firm's business treats all partners equally. Recovering the profits earned from completing the firm's unfinished business is an important source of revenue to help facilitate an orderly dissolution.

B. There Will Be No Cottage Industry Of Fee Litigation If Partners And Law Firms Respect The Duty Of Law Partners To Meet Their Obligations To Prior Partnerships.

Respondents' argument that this Court should cast aside the Legislature's decision to require partners to account back for all

profits earned in the dissolution, but are entitled "to reasonable compensation for services rendered" under Corporations Code section 16401(h), because it will give rise to a "cottage industry" of litigation is meritless. The job of courts is to fashion workable rules to implement the statutory provisions passed by the Legislature. Respondents offer nothing but speculation in contending that settled standards guiding the determination of what constitutes "profit," "reasonable compensation," and expenses attributable to completing the unfinished business cannot be developed over time as cases are litigated.

There exists a wealth of readily available data analyzing law firm profitability that includes detailed measurements of all aspects of law firm economics. (See e.g., 2017 Client Advisory, http://amlawdaily.typepad.com/2017CitiReport.pdf; Calculating Profits, http://www.altmanweil.com; Your Financial Dashboard, http://www.americanbar.org/publications/law_practice_magazine/2013/september-october/your-financial-dashboard.html.) Trial courts are well suited to establish rules to allow fact-finding as to what constitutes reasonable compensation as opposed to profits. Indeed, the discovery in the cases at issue showed that law firms consistently maintain internal data to track the expected and actual profitability of lateral partner hires. (See generally ER 18 – 41.) The parties presented competing expert testimony regarding their contentions as to the measure of the profits earned for completing the unfinished business the calculation of reasonable compensation to the Respondents (See *id.)*

The adversarial system is well-equipped to measure damages in a wide range of different contexts and applying countless statutes. Sophisticated parties often will negotiate methodologies to arrive at reasonable settlements, as was the result with the vast majority of the cases originally filed by Heller. OB at 8. Respondents' concerns about endless litigation are unfounded.

CONCLUSION

The Unfinished Business Rule rests on, and strengthens, the time honored fiduciary duties that partners owe to each other and to the partnership. The business of law benefits because the rule reinforces the rights that the partnership has to protect, and allow it to recover for, the collective investments of all the partners that create partnership opportunities. The practice of law benefits because the rule maintains respect for the loyalty of law partners (and other partners) to each other and to all the lawyers that work on cases together. The public benefits when lawyers apply the law equally to themselves and when creditors are able to maximize the recoveries of debts left unpaid when law firms dissolve.

This Court should find that, under California law, a dissolving law partnership has protectable property interests in the hourly legal matters in progress but not completed at the time the law firm is dissolved and in recovering the profits generated by the partners of the dissolving firm in completing those matters.

Date: March 24, 2017

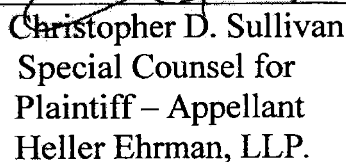
Christopher D. Sullivan

CERTIFICATE OF COMPLIANCE

I hereby certify that this brief has been prepared using proportionately one and one half spaced, 14 point, Times New Roman typeface. According to the "Word Count" feature in my Microsoft Word for Windows software, this brief contains 8,398 words up to and including the signature lines that follow the brief's conclusion.

I declare under penalty of perjury that this Certificate of Compliance is true and correct and that this declaration was executed on March 24, 2017

DIAMOND MCCARTHY LLP

By: 

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PROOF OF SERVICE

State of California, County of San Francisco

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

On March 24, 2017, I served true copies of the **REPLY BRIEF** on the interested parties in this action as follows:

PLEASE SEE ATTACHED SERVICE LIST

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

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

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

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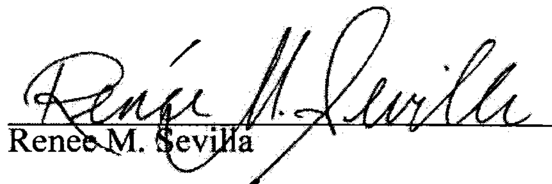
____(STATE) I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

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

Executed on March 24, 2017 at San Francisco, California.



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Supreme Court Case No: S236208

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