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December 19, 2007

The Honorable Chief Justice Ronald M. George
and Associate Justices
Supreme Court of California
350 McAllister Street
San Francisco, CA 94102

Re: Petition for Review of *Everest Properties II, LLC and Everest Management, LLC v. Prometheus Development Co., Inc. and Sanford N. Diller*,
Supreme Court No. S157984 (Petition for Review filed Nov. 6, 2007)
Court of Appeal, First Appellate District, Case No. A114305,
San Mateo County Superior Court, No. CIV 436873

To the Honorable Chief Justice Ronald M. George and the Associate Justices of the Supreme Court of California:

The Washington Legal Foundation (WLF) hereby submits this letter as amicus curiae in support of the Petition for Review filed by Prometheus Development Co., Inc. and Sanford N. Diller in *Everest Properties II, LLC and Everest Management, LLC v. Prometheus Development Co., Inc. and Sanford N. Diller* pursuant to Rule 8.500(g) of the California Rules of Court.

INTEREST OF AMICUS CURIAE

WLF is a national non-profit public interest law and policy center based in Washington, D.C., with supporters nationwide, including many individuals and businesses in California. Since its founding in 1977, WLF has devoted a substantial portion of its resources to promoting free-enterprise principles, economic and property rights, a limited and accountable government, and legal reform in our civil justice system. WLF carries out its mission by direct litigation and participating as amicus curiae in scores of precedent-setting cases in the U.S. Supreme Court and state courts, including this Court, and by publishing educational materials on the subject through its Legal Studies Division. Additional information about WLF's legal activities can be found on WLF's website at *www.wlf.org*.

WLF submits that it is in the public interest to have clear, consistent, and fair rules governing the conduct of business and commerce based on sound legal principles and legislative intent. For example, WLF filed an amicus curiae letter in this Court in support of the petition for review, as well as a follow-up brief on the merits, in *City of Hope National Medical Center v. Genentech, Inc.*, No. S129463 (case pending). *Genentech* warranted review by this Court because of the important issue it raised regarding the existence and alleged breach of a fiduciary duty by Genentech in a contractual licensing relationship with the City of Hope Hospital for the payment of royalties. In that case, WLF argued that the court of appeal's novel imposition of a fiduciary duty on Genentech was a pernicious "tortification" of contract law by judicial fiat, which in turn was used to support an unconstitutionally excessive punitive damage award otherwise unavailable under California law for breach of contract. The case at bar also raises significant issues affecting the business community and the broader public interest that should be resolved by this Court.

ARGUMENT

The Petition for Review raises an important issue, similar in some respects to the issue in *Genentech*, namely, the nature and scope of a party's fiduciary duties -- but here, in the context of a partnership relationship created by contract.[1] In particular, the court below ruled that a general partner who proposes a self-interested transaction, which is permissible under California partnership law, has a duty to all the other partners to ensure that the transaction is not only procedurally fair but also substantively or inherently fair to the other partners, even though the details of the transaction were disclosed to the other partners and a majority of them voted to approve the transaction.

To reach this result, the Court of Appeal extended the "inherent fairness doctrine," heretofore applicable only in corporate context between majority and minority shareholders, to the partnership context. As the Petition for Review makes clear, that ruling stands in stark contrast to the holding of another Court of Appeal and two U.S. District Court rulings interpreting California law, one of which involves the very same dispute as the instant case

[1] The Petition for Review also seeks review of an equally important issue of whether the exclusion of a party's only expert witness in a case where expert testimony is essential to the defense necessarily creates prejudice and requires reversal. The Court of Appeal held that the exclusion of this key witness by the trial court was error, but harmless. While amicus urges this Court to grant review of that significant issue as well, WLF will focus on the first issue raised by the Petition.

(and brought by the same plaintiffs' counsel albeit on behalf of different limited partners). For that reason alone, review is warranted by this Court to resolve the conflict and confusion between the cases.

Amicus submits that review is also desirable because the ruling below ignores recent statutory changes in California partnership law, which does away with the notion that a partner has the same duties as a trustee and instead limits, rather than expands, the partners' fiduciary duties. This judicial disregard of the recent legislative shift of partnership fiduciary duties under tort law to a more "contractarian" focus is just as unsettling as the judicial activism of the "tortification" of contract law in the *Genentech* case. In both cases, lower appellate courts are making substantial changes in the law governing business relationships that call for a definitive ruling that only this Court can and should make.

Because many businesses and enterprises in California operate as partnerships, it is imperative that this Court clarify California law in this area. Partnerships will not be able to operate optimally if the law in this area lacks certainty and predictability. Counsel will not be able to properly advise their clients about whether the "inherent fairness doctrine" does or does not apply to partnerships in California. Completed transactions involving partnerships would remain unsettled -- and would potentially expose partners to extensive liability -- if courts are able to second-guess whether those transactions were inherently fair, despite full disclosure of the nature and terms of the transaction and procedural fairness. This unsettled state of the law can only lead to confusion, unnecessary litigation and coerced settlements, all of which are contrary to the public interest.

I. This Court Should Decide Whether the Doctrine of Inherent Fairness Applies To Partnerships.

As the Petition for Review discusses at length (Petition at 5-9), Prometheus Development Co., Inc. (PDC), the general partner of the limited partnership, and Sanford N. Diller, PDC's officer and director, went to great lengths to fully disclose the facts and the conflict of interest involved in the proposed merger of the limited partnership. Those efforts included, *inter alia*, the filing of detailed proxy statements with the Securities and Exchange Commission (SEC) following extensive and thorough review of the proxy materials by the SEC, with revisions made to the proxy materials in response to the SEC's suggestions. Everest concedes that the conflict was fully disclosed, that California law permits a general partner to benefit from a partnership transaction, and that the partners approved the transaction.

Despite this procedural fairness, the Court of Appeal explained that a general partner is a fiduciary who not only must act in good faith, but also must show the transaction's "inherent fairness from the viewpoint of the corporation and those interested therein. . . ." *Everest Props. II v. Prometheus Dev. Co.*, No. A114305, 2007 WL 2703374 at *17 (Sept. 27, 2007). The Court of Appeal rejected PDC's arguments that the "inherent fairness" doctrine applies only to relationships between controlling and minority shareholders. In doing so, it became the first and only California court to rule that the doctrine applies to partnerships as well.

Everest argues that the fiduciary duties of a general partner, whether denominated as good faith and fair dealing or inherent fairness, is simply a matter of semantics. Not so. To the contrary, amicus submits that the difference between procedural fairness and inherent or substantive fairness works a fundamental change in partnership jurisprudence in California.

For example, in *In re Real Estate Assoc. Ltd. v. P'ship Litig.*, 223 F. Supp. 2d 1109 (C.D. Cal. 2002), the district court ruled that the inherent fairness doctrine does not apply to partnerships under California law, addressing the issue not in passing or mere dicta, but specifically holding as follows:

> B. Doctrine of Inherent Fairness
>
> In Jones v. H.F. Ahmanson & Co., the California Supreme Court held that when a majority shareholder usurps a corporate opportunity or otherwise harms the minority shareholder, the majority shareholder must show it did not breach its fiduciary duty or the doctrine of inherent fairness. 1 Cal.3d 93, 108, 460 P.2d 464, 81 Cal. Rptr. 592 (1969); see also Miles, Inc. v. Scripps Clinic & Research Found., 810 F. Supp. 1091, 1099 (S.D. Cal. 1993). The doctrine of inherent fairness stands for the proposition that "once it is shown a director received a personal benefit from the transaction . . . the burden shifts to the director to demonstrate not only the transaction was entered in good faith, but also to show its inherent fairness from the viewpoint of the corporation and those interested therein." Heckmann v. Ahmanson, 168 Cal. App. 3d 119, 128, 214 Cal. Rptr. 177 (1985). "The essence of the test is whether or not under all the circumstances the transaction carries all the earmarks of an arm's length bargain. If it does not, equity will set it aside." Jones, 1 Cal. 3d at 108 (internal quotations & citation omitted). The California Supreme Court specifically held in Jones that the doctrine of inherent fairness exists only between majority and minority shareholders. Lynch v. Cook, 148 Cal. App. 3d 1072, 196 Cal. Rptr. 544 (1983); McCormick v.

> Fund Am. Cos., Inc., 26 F.3d 869, 884 (9th Cir. 1994).
>
> The relationship between the defendants and the Class is not one of majority and minority shareholder, but rather of partners. While California law holds that a fiduciary relationship exists between general and limited partners, it does not hold that the doctrine of inherent fairness extends to partnerships. Id. The plaintiffs do not cite any authority to the contrary (footnote cited omitted).
>
> Therefore, the Court grants the defendants' motion for summary judgment as to the plaintiffs' claim for breach of the doctrine of inherent fairness (Count VI in the CSRAC).

Id. at 1137-38.

In addition to this crystal clear holding that conflicts with the decision below, another federal district court similarly ruled in a case involving the same transaction at issue here, and dismissed the claims that the merger was not inherently fair. *Perretta v. Prometheus Development Co.*, No. C 05-02987 WHA 2006 WL 463533 (N.D. Cal. Feb. 24, 2006) (appeal pending) (calendared for Feb. 11, 2008).

Finally, the decision below conflicts with another California Court of Appeal decision, *Skone v. Quanco Farms*, 261 Cal. App. 2d 237 (5th Dist. 1968). *Skone* held that there is "no breach of fiduciary duty if there has been a full and complete disclosure, if the partner who deals with partnership property first discloses all the facts surrounding the transaction to the other partners and secures their approval and consent." *Id*. at 241.

As the Petition makes clear, this notion of procedural fairness is quite different from substantive fairness. Everest's attempt to conflate the two concepts and downplay the conflicting jurisprudence should be rejected. There either is or there is not a rule of law in California that the inherent fairness doctrine applies to partnerships. This case provides the Court with the perfect vehicle to clarify the law on this important issue.

II. This Court Should Clarify the Scope of California Partnership Law.

Review in this case is particularly important in light of the fact that this Court has not weighed in on the scope of partnership duties in light of the changes the Revised Uniform Partnership Act (RUPA) made to partnership law in California. Although California may not have taken RUPA as far as some other states have, the adoption of RUPA in California has at

least made clear that the duties of partners are different from the duties owed by trustees. This Court, which has not discussed the nature of a partner's duties since 1987, should use this opportunity to clarify the scope of partnership duties post-RUPA.

RUPA, which became effective in California for pre-existing partnerships like the one in this case on January 1, 1999, "attempts to displace the common law and define the fiduciary duties of partners entirely by statute." HILLMAN, ET AL., *supra*, at 258 (2007); *see* RUPA § 404(a)-(b). "The formulation is exclusive in two ways: the duties of loyalty and care are the only components of the partners' fiduciary duties, and the duties themselves are exclusively defined." HILLMAN, ET AL., *supra*, at 259 (2007).

Further, § 404(e) of RUPA and Cal. Corp. Code § 16404(e) state that "[a] partner does *not* violate a duty or obligation under this chapter or under the partnership agreement merely because the partner's conduct furthers the partner's own interest." (emphasis added). According to HILLMAN ET AL., there are two interpretation of this section:

> Under the narrow interpretation, Section 404(e) is essentially an evidentiary rule which could be paraphrased as 'the fact that a partner directly personally benefits from the partner's conduct in the partnership context does not, without more, establish a violation of the partner's duties or obligations under RUPA or the partnership agreement. Under the broad interpretation, Section 404(e) means that partners are free to pursue their short-term, individual self-interest without notice to or consent of the partnership, subject only to the specific restrictions contained in Section 404(b) duty of loyalty—in effect that the pursuit of self-interest cannot be a violation of the non-fiduciary obligation of good faith and fair dealing.

HILLMAN, ET AL., *supra*, at 265-66 (2007). This section is "[p]otentially, one of the most powerful changes in partnership law under R.U.P.A." HILLMAN, ET AL., *supra*, at 265.

Another change RUPA brings is the "good faith and fair dealing" component. Under the Uniform Partnership Act (UPA) and the common law, the duty of good faith and fair dealing were fiduciary duties. Now, partners have an "obligation of good faith and fair dealing." RUPA § 404(d); Cal. Corp. Code § 16404(d). This obligation "is a contract concept, imposed on the partners because of the consensual nature of a partnership. It is not characterized, in RUPA, as a fiduciary duty arising out of the partners' special relationship.

Nor is it a separate obligation." RUPA § 404 cmt. 4 (internal citation omitted).

RUPA "represents a major shift away from the fiduciary view [of the partnership relationship] and toward the 'libertarian' or 'contractarian' view, by (a) expressly limiting fiduciary duties, (b) sanctioning a partner's pursuit of self-interest, and (c) allowing partners to waive most fiduciary duties by contract." *Celcom v. AT&T Wireless Servs. Inc.*, 169 P.3d 823, 826 (Wash. 2007) (Madsen, J., concurring). As the Petition correctly notes, post-RUPA, "[a] partner as such is not a trustee and is not held to the same standards as a trustee." RUPA § 404(e) cmt. 5 (1997).

Despite California's adoption of RUPA, courts continue to impose pre-RUPA fiduciary duties on partners. For example, many of the cases that both parties in this case cite contain some stray language equating the duties of partners with the duty of a trustee. *See, e.g.*, *Enea v. Superior Court*, 132 Cal. App. 4th 1559, 1565 (6th Dist. 2005); *Bardis v. Oates*, 119 Cal. App. 4th 1, 12 (3d Dist. 2004); *Everest Investors 8 v. McNeil Partners*, 114 Cal. App. 4th 411, 424-25 (2d Dist. 2003); *BT-I v. Equitable Life Assurance Society*, 75 Cal. App. 4th 1406, 1410-11 (4th Dist. 1999).

In his concurring opinion in *Celcom*, Justice Madsen acknowledged the need to reexamine "the scope of a partner's fiduciary duty of loyalty in the context of a self-dealing transaction . . . . in light of changes in the law" since Washington adopted RUPA. *Celcom*, 169 P.3d at 826. When California adopted RUPA, it departed somewhat from the exact language of § 404. Section 404 of RUPA states that "[a] partner's duty of loyalty to the partnership and the other partners is limited to the following . . . ." RUPA § 404(b). The three specific rules that are listed "are exclusive and encompass the entire duty of loyalty." RUPA § 404 cmt. 2. Section 16404 of the California Corporate Code (California's version of RUPA), however, states that "[a] partner's duty of loyalty to the partnership and the other partners *includes* all of the following . . . ." This raises the question of whether the California legislature intended to keep the common law and the UPA view of partnership law intact, a question worthy of this Court's review. *See also Partners Owe to One Another a Duty of the Finest Loyalty . . . or Do They? An Analysis of the Extent to Which Partners May Limit Their Duty of Loyalty to One Another*, 37 TEX. TECH. L. REV., 433, 445-46 (2005) ("[t]he important principle is disclosure").

At least one court of appeal has recognized that the meaning of § 16404(e) is unsettled. While holding that this section does "not empower [the defendants] to occupy partnership property for their own exclusive benefit at partnership expense, in effect converting partnership assets to their own," the Court declined to decide which view of

RUPA § 404(e) "prevails in California." *Enea v. Superior Court*, 132 Cal. App. 4th 1559, at 1566 n.3 (6th Dist. 2005). Thus, the meaning of § 16404(e) is still unclear in California, and this case presents an ideal vehicle for the Court to explicate the law in this area.

CONCLUSION

For the foregoing reasons, this Court should grant the Petition for Review and clarify the fiduciary duties applicable to partners, particularly in light of the fundamental change brought about by RUPA.

Respectfully submitted,

/Daniel J. Popeo

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Chairman & General Counsel

/Paul D. Kamenar

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Senior Executive Counsel
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cc: All Counsel of Record (see attached Proof of Service)

PROOF OF SERVICE

I, Paul D. Kamenar, hereby declare:

I am over the age of 18 years and not a party to or interested in the within entitled cause. I am an employee of the Washington Legal Foundation and my business address is 2009 Massachusetts Ave., N..W., Washington, D.C., 20036. On the date stated below, I served a true copy of:

LETTER OF AMICUS CURIAE WASHINGTON LEGAL FOUNDATION IN SUPPORT OF THE PETITION FOR REVIEW.

(x)By mail, by placing said document(s) in an envelope addressed as shown below. I am readily familiar with my firm's practice for collection and processing of correspondence for mailing with the United States Postal Service. Said correspondence will be deposited with the United States Postal Service this same day in the ordinary course of business. I sealed said envelope and placed it for collection and mailing on the date stated below to the addressee stated below, following the firm's ordinary business practices.

( ) by overnight delivery by enclosing a true and correct copy of said document(s) in United Parcel Service envelope(s) addressed as set forth below. The envelope(s) was (were) sealed and deposited with the United Parcel Service that same day in the ordinary course of business at Washington, D.C.

( ) by messenger by handing a copy of said document(s) to _____, for personal service by its agent to the person(s) at the address(es) set forth below.

( ) by personally delivering the document(s) to the person(s) at the address(es) set forth below.

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I declare under penalty of perjury, under the laws of the District of Columbia that the foregoing is true and correct, and that this declaration was executed at Washington, D.C. on December 19, 2007.

Paul D. Kamenar