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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA  
FIFTH APPELLATE DISTRICT

MARVIN J. DERRICK, M.D.,

Plaintiff and Respondent,

v.

CALIFORNIA CARDIAC SURGEONS et al.,

Defendants and Appellants.

F061580

(Super. Ct. No. S1500CV266855)

**OPINION**

APPEAL from a judgment of the Superior Court of Kern County. Sidney P. Chapin, Judge.

Dake, Braun & Monje and Richard A. Monje for Defendants and Appellants.

Noriega & Associates and Robert J. Noriega for Plaintiff and Respondent.

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Plaintiff Marvin J. Derrick, M.D., elected to withdraw from a medical partnership known as California Cardiac Surgeons, a Medical Group (CCS), and he requested that his one-third interest therein be purchased by CCS in accordance with the terms set forth in paragraph 11.6 of the Restated Partnership Agreement (the Partnership Agreement). However, he was unable to reach agreement with the other two CCS partners, Sarabjit S. Purewal, M.D., and Patrick T. Paw, M.D., regarding the buyout price. Derrick sued CCS, Purewal, and Paw (collectively defendants) for an accounting to determine the value of his partnership interest and to enforce his alleged right to be paid for that interest. Purewal and Paw filed a cross-complaint relating to the same issues. The point of contention between the parties was whether Derrick's proportionate share of CCS's office lease had to be included as a liability when computing the buyout price. A second dispute emerged as to whether the buyout price should be calculated based on paragraph 11.6 of the Partnership Agreement or under Corporations Code section 16701.<sup>1</sup> At trial, Derrick's accounting expert testified that the lease should not be treated as a CCS liability in computing the value of Derrick's partnership interest. The trial court agreed with that analysis and also found that paragraph 11.6 was applicable in this case. The trial court then rendered its accounting based on evidence presented at trial and concluded that defendants owed Derrick the sum of \$277,657. Defendants appeal from the judgment. We will affirm.

### **FACTS AND PROCEDURAL HISTORY**

In September 2001, Derrick, Purewal and Paw and several other medical doctors entered into the Partnership Agreement regarding CCS, which is a California general partnership. At that time, there were two medical offices operated under the Partnership

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<sup>1</sup> Unless otherwise indicated, all further statutory references are to the Corporations Code. For clarity, we refer to statutory provisions as "sections," and numbered provisions in the Partnership Agreement as "paragraphs."

Agreement, one in Bakersfield and one in Ventura, California. In 2007, the Ventura doctors separated from the Bakersfield doctors pursuant to an “AGREEMENT FOR REORGANIZATION AND DISSOCIATION.” The Partnership Agreement remains the operative agreement defining the rights and responsibilities of the Bakersfield partners, including Derrick, Purewal and Paw.

On January 17, 2003, CCS entered into a lease of yet-to-be constructed medical office space in Bakersfield, California, for a 10-year term. The lease was signed by the four Bakersfield partners at that time—Derrick, Purewal, Paw and Bruce Frazier, M.D. The lease term commenced on August 1, 2005, and will expire on July 31, 2015. By the time the lease term commenced, Dr. Frazier had dissociated from CCS and was no longer a partner, so only Derrick, Purewal and Paw moved into the new medical office space. The rentable space amounted to 8,111 square feet. The base rental rate was \$1.10 per square foot, payable in monthly installments on the first day of each month, plus a share of common area operating expenses. The total amount due each month under the lease was more than \$12,000.

CCS sublet a portion of the premises to Bakersfield Varicose Vein Center (BVVC) under a Management Services Agreement involving sharing of some office space, computer equipment and administrative services in return for which BVVC would pay (among other amounts) a percentage of revenue it generated. BVVC was owned and run by Derrick as a separate medical practice. In October 2007, the compensation provision was amended so that CCS would receive a flat rate of \$4,600 per month. CCS also sublet medical office space to Carolyn Wong, M.D. (Paw’s wife), for what Paw said was a fair rental rate.

In 2008, the relationship between Derrick, Purewal and Paw deteriorated. Derrick wanted to expel Paw from the partnership, or to leave and form a new partnership. In July 2008, Purewal announced by letter that if any of the three partners left CCS, then as far as he was concerned the partnership “will be dissolved leaving each Partner to resolve

their debt issues individually until 2015.” In September 2008, Purewal and Paw, through their attorney, informed BVVC that its agreement with CCS would not be continuing and that BVVC would have to remove its operation from CCS’s office space.

In a letter dated December 29, 2008, Derrick formally notified Purewal and Paw that he was withdrawing from the partnership effective January 1, 2009. In that letter, Derrick’s attorney stated: “Please accept this letter as Dr. Derrick’s notice of withdrawal from the partnership ... pursuant to [paragraph] 11.1 of the partnership agreement. Dr. Derrick requests that the partnership purchase his partnership interest in accordance with [paragraphs] 11.6 and 11.7 of the partnership agreement and section 16701 .... Finally, Dr. Derrick requests that the partnership agree to indemnify him against partnership liabilities, including the ongoing rental obligation, in accordance with [paragraph] 11.9 of the partnership agreement and section 16701[, subdivision ](d) ....”

Effective January 1, 2009, an amendment to the Partnership Agreement, signed by Purewal and Paw, reflected that Derrick was no longer a partner, and also added a new partner to CCS—namely, Eric Peck, M.D.

By letter dated February 5, 2009, the attorney representing defendants responded to Derrick’s buyout request. The letter stated that under the Partnership Agreement, the only two options were buyout or dissolution: “[Paragraph] 11.1 of the Partnership Agreement provides that the ‘Partnership shall dissolve unless the interest in the partnership of such partner is purchased as provided herein.’ While we do not believe that it is the best option available to all parties in this matter, we are prepared for dissolution of the Partnership should we not be able to reach an amicable solution.” The letter specifically rejected the request that Derrick be released from the future rental obligation: “[T]he partnership and the remaining partners are in no way inclined to release Dr. Derrick from his ongoing rent obligation. A partner’s disassociation/withdrawal does not of itself discharge the partner’s liability for a partnership obligation incurred before disassociation/withdrawal. Furthermore, as you

are aware Dr. Derrick has signed a personal guaranty as have the other partners with regards to the rental obligation. If we cannot come to some type of an agreement regarding this issue, and the partnership dissolves, then the rent obligation will be spread equally between the three partners ....”

Additionally, defendants’ February 5, 2009, letter offered that if Derrick paid \$150,000 (the discounted value of Derrick’s share of all future rent), the remaining partners would be willing to release him of the lease obligation. If that offer was not accepted, the letter stated the only remaining options were to dissolve and wind-up the partnership or “to proceed with the purchase of Dr. Derrick’s interest at which time we would enforce the Covenant Not To Compete pursuant to [paragraph] 11.12”<sup>2</sup>

By letter dated March 11, 2009, Derrick’s attorney responded to defendants’ February 5, 2009 letter. The proposal that Derrick pay \$150,000 to be ““relieved”” of his rental obligations was rejected because “Dr. Derrick has no liability to CCS for ongoing partnership liabilities, including future rent obligations, under [paragraph] 11.9 of the partnership agreement and section 16701[, subdivision ](d) ....” The March 11, 2009, letter reiterated that Derrick wanted to proceed with the partnership’s purchase of his partnership interest. It was requested that “the partnership promptly render a purchase price for Dr. Derrick’s partnership interest in accordance with [paragraph] 11.6 of the partnership agreement.”

On April 2, 2009, Derrick filed his complaint. In the first cause of action for accounting, the complaint alleged that Derrick gave notice of his withdrawal from the partnership on December 29, 2008, and that the effective date of withdrawal was January 1, 2009. The complaint alleged that Derrick requested that CCS purchase his

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<sup>2</sup> Initially, there was an additional dispute concerning the enforceability of the covenant not to compete set forth in the Partnership Agreement. That issue became moot when Derrick moved his medical practice to Illinois.

one-third partnership interest in accordance with paragraphs 11.6 and 11.7 of the Partnership Agreement and section 16701, but defendants have failed and refused to provide Derrick with a calculation of the value of his interest in the CCS partnership. “Rather, Defendants CCS, Paw, and Purewal have only contended that [Derrick] must pay a share of the ongoing liabilities of defendant CCS.” In his prayer for relief, Derrick asked “[f]or the value of [Derrick’s] interest in the partnership to be ascertained for payment of any and all sums that may be found owing to [Derrick] for his interest in the partnership.”

At approximately the time frame that Derrick’s complaint was filed, Purewal and Paw directed Wayne Long, CPA, the accountant who prepared tax returns for CCS, to calculate the buyout price pursuant to paragraph 11.6 of the Partnership Agreement. Mr. Long did so, and he *included* the lease liability in his calculations.<sup>3</sup> He concluded that Derrick’s partnership interest was valued as *negative* \$116,173. In other words, Long’s calculation was that Derrick owed CCS the sum of \$116,173. Long’s calculation of the buyout amount was set forth in a written itemized document (referred to by the parties as trial exh. No. 11), which was not delivered to Derrick or Derrick’s attorney until May 27, 2009.

On July 20, 2009, defendants answered the complaint, and Purewal and Paw filed a cross-complaint that included causes of action for accounting, breach of contract and declaratory relief. The cross-complaint alleged that Purewal and Paw were entitled “either to enforce the buy out provision in the CCS partnership agreement or dissolve CCS and proceed with a winding up and dissolution.” Elsewhere in the cross-complaint, however, the allegations reflect that an election to proceed with the buyout under paragraph 11.6 (rather than dissolution) had been made. (See, e.g., ¶¶ 18, 20, 21, 46 &

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<sup>3</sup> It is unclear whether Mr. Long was directed to include the lease liability.

49 of the cross-complaint.) We will consider these allegations in greater detail in the discussion portion of this opinion.

The cross-complaint noted parenthetically that Derrick's request for CCS to buy out his partnership interest had referenced, in addition to paragraphs 11.6 and 11.7 of the Partnership Agreement, the authority of section 16701. The cross-complaint did not allege that section 16701 was applicable. On information and belief, it alleged that application of the buyout methodology of section 16701, subdivision (b), would yield the same or similar results as would be obtained under the Partnership Agreement.

By the time of trial, Purewal and Paw argued that the buyout had to be calculated based solely on the terms of section 16701, subdivision (b). They no longer claimed that Mr. Long's evaluation under paragraph 11.6 of the Partnership Agreement should be used, and in fact they insisted that paragraph 11.6 was inapplicable because they never exercised the option to buy out Derrick under the Partnership Agreement. Jim Bock, CPA, an accounting expert for Purewal and Paw, calculated the value of Derrick's partnership interest under the terms of section 16701 as a *negative* \$70,569. Mr. Bock included Derrick's share of the long-term lease obligation in his calculation, using a discounted present value of the future sums due under the lease.

Michael Hooper, CPA, an accounting expert for Derrick, testified that under generally accepted accounting practices applicable to CCS, which he described as tax-basis accounting (or a modified cash-basis accounting), the multi-year lease would not be recognized as a liability because it was only to be treated as an obligation or expense each month as the rent became due for use of the space being rented. That is, "operating leases" are "a cost of doing business that each month as that rental payment comes due, you receive a benefit for that space that you are renting that is equal to or in some times greater than the cost that you are incurring on a monthly basis." He therefore disagreed with Long's treatment of future rent payments as a liability for which Derrick was allocated a one-third share. Mr. Hooper testified that in computing the buyout price

under paragraph 11.6 of the Partnership Agreement, the lease should not be included as a liability. He stated he would calculate the buyout price by taking the numbers in trial exhibit 11 (Mr. Long's calculation), eliminating the lease obligation and then redoing the math. Using this method, Mr. Hooper concluded that Derrick was due a total of \$181,917 from CCS.

Another expert accountant, Peter Brown, testified for Derrick by offering an opinion that under standard double-entry accounting practices, *even if* the lease was treated as a liability on a financial statement, you would ordinarily include as a corresponding asset the value of the leasehold (the right to use the premises for a period of time). In this case, the two entries would cancel each other out.

Following a two-day bench trial, the trial court issued a statement of decision. In its statement of decision, the trial court held that the buyout provision in the Partnership Agreement (§ 11.6) was applicable for several reasons, including admissions in Purewal's and Paw's cross-complaint and the fact that there was no evidence of a dissolution or winding up of the partnership. Based on expert testimony, the trial court concluded that the operating lease obligations, including future rent and common area charges, did not constitute a liability to be deducted from the value of Derrick's interest in the partnership. The trial court then specified its findings as to Derrick's share of the partnership assets, accounts receivables and liabilities, with references to supporting evidence as to each item, and concluded based on those numbers that Derrick was entitled to be paid a buyout price of \$277,651.<sup>4</sup>

Judgment was entered in favor of Derrick, and against defendants, in the sum of \$277,651. Thereafter, the trial court awarded Derrick the recovery of the additional sum

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<sup>4</sup> The figures appear to be mainly as shown in trial exhibit 11 (Mr. Long's calculation of Derrick's interest), except that the lease obligation was removed from the calculation and increased sums for accounts receivable were indicated.

of \$62,105, for his attorney fees as the prevailing party, pursuant to Code of Civil Procedure section 1717. Thereafter, defendants filed the instant appeal.

## **DISCUSSION**

### **I. Buyout was Governed by Partnership Agreement**

The first issue before us is whether the trial court applied the correct legal standard in computing the buyout amount due to (or owed by) Derrick after he withdrew from CCS. The trial court held that paragraph 11.6 of the Partnership Agreement was applicable because, among other things, Purewal and Paw admitted in their cross-complaint that they were pursuing the buyout option under that provision and, furthermore, there was no evidence of a dissolution or winding up of CCS. Defendants contend the trial court erred because their pleading did not make the admission indicated by the trial court. Moreover, defendants contend they did not exercise the option to purchase Derrick's partnership interest within the 60-day period called for under the Partnership Agreement and, therefore, the contractual buyout provision never took effect. As a result, defendants claim the valuation of Derrick's interest was governed by section 16701, subdivision (b).

Because this matter involves the question of what legal standard should be applied to a given set of facts, we apply a de novo review. (*Crocker National Bank v. City and County of San Francisco* (1989) 49 Cal.3d 881, 889.) We also apply a de novo review to the interpretation of a written contract where, as here, such interpretation does not depend on the credibility of conflicting extrinsic evidence. (*Parsons v. Bristol Development Co.* (1965) 62 Cal.2d 861, 865-866.) We will begin our discussion with a brief overview of the relevant terms of the Partnership Agreement and of section 16701, and then explain how the contractual and statutory provisions relate to each other.

#### **A. Relevant Terms of Partnership Agreement**

Paragraph 11.1 of the Partnership Agreement provided that in the event a partner withdraws from the partnership, "the Partnership shall dissolve unless the interest in the

Partnership of such Partner is purchased as provided herein.” Paragraph 11.2 then explained the process of purchasing the withdrawing partner’s interest, providing that in the event of withdrawal by a partner, the partnership (or the remaining partners) “shall have the option to purchase the Partnership interest of such Partner by paying such Partner ... the value of such interest, to be determined as provided in [paragraph] 11.6.” The next sentence stated: “The Partnership (or Partners ... ) shall give notice of exercise to such Partner ... at any time within sixty (60) days after the event giving rise to the Partnership’s option to purchase.”

Thus, according to the clear and unequivocal terms of the Partnership Agreement, when a partner withdraws, there were only two options: (1) dissolution<sup>5</sup> (which “shall” occur “unless the interest in the partnership ... is purchased”), or (2) purchase of the partner’s interest as provided in the Partnership Agreement, which option is exercised by the partnership (or the remaining partners) by giving written notice thereof within 60 days after the withdrawal.<sup>6</sup>

Paragraph 11.4 of the Partnership Agreement provided that if there was not unanimous consent to have the partnership purchase the interest of the withdrawing partner, one or more of the remaining partners may do so. According to paragraph 11.5, the remaining partners would continue to operate the business of the partnership “pending the decision of the Partnership or remaining Partners to exercise the option.”

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<sup>5</sup> Dissolution was covered in article XIII of the Partnership Agreement, and required the prompt publication of notice of dissolution, the appointment of a liquidating partner, the winding up of the affairs of the partnership, the discharging of all obligations and the distribution of remaining assets. Nothing in the record suggests the parties ever pursued the option of dissolution in this case.

<sup>6</sup> A “purchase” of the partner’s interest is used interchangeably herein with the term “buyout.”

If the decision was made to purchase the withdrawing partner's interest in the partnership, the purchase price was to be determined as provided in paragraph 11.6, which read as follows: "The purchase price for the Partnership interest then being acquired shall be determined by the independent certified public accountant who prepares the Partnership's tax returns. In so determining the value, the accountant shall consider what the Partner would have received had the Partnership sold its property for its current book value, had collected that amount of outstanding accounts receivable that are normally and customarily received (based on the average collection rate for the two preceding years) and the Partnership had paid all its debts, liabilities and other obligations to third parties and had distributed its remaining cash pursuant to the dissolution provisions contained in Article XIII of this Agreement. In determining this value, any amount owed by that Partner to the Partnership shall reduce the value of that Partner's interest in the Partnership."

Additionally, paragraph 11.9 stated that upon making such purchase, "the Partnership shall assume the Partnership obligations and shall protect and indemnify the Partner ... from liability for any such obligations." Paragraph 11.12 provided that the selling (withdrawing) partner covenants not to compete in the same geographic region for a period of three years. Paragraph 11.13 provided that "[w]henver the Partnership exercises an option to acquire a Partnership interest [rather than dissolve], the remaining Partners shall have the right to continue the Partnership business under its present name."

B. Section 16701

Section 16701 refers to a withdrawing partner as one who is "dissociated" from the partnership. (§ 16701, subd. (a).) The specific provision addressing buyout price is subdivision (b) of section 16701. For context, we have set forth below many of the significant provisions in section 16701:

“Except as provided in Section 16701.5,<sup>[7]</sup> all of the following shall apply:

“(a) If a partner is dissociated from a partnership, the partnership shall cause the dissociated partner’s interest in the partnership to be purchased for a buyout price determined pursuant to subdivision (b).

“(b) The buyout price<sup>[8]</sup> of a dissociated partner’s interest is the amount that would have been distributable to the dissociating partner under subdivision (b) of Section 16807 if, on the date of dissociation, the assets of the partnership were sold at a price equal to the greater of the liquidation value or the value based on a sale of the entire business as a going concern without the dissociated partner and the partnership was wound up as of that date. Interest shall be paid from the date of dissociation to the date of payment. [¶] ... [¶]

“(d) A partnership shall indemnify a dissociated partner whose interest is being purchased against all partnership liabilities, whether incurred before or after the dissociation, except liabilities incurred by an act of the dissociated partner under Section 16702.

“(e) If no agreement for the purchase of a dissociated partner’s interest is reached within 120 days after a written demand for payment, the

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<sup>7</sup> Section 16701.5 provides that section 16701 “shall not apply to any dissociation that occurs within 90 days prior to a dissolution under Section 16801.”

<sup>8</sup> Subdivision (b) of section 16701 makes use of the term “buyout price.” Recent case law suggests that use of that distinct term in the statute was for the purpose of allowing the term to be developed as an independent concept appropriate to the partnership buyout situation, while drawing on valuation principles developed elsewhere. (*Rappaport v. Gelfand* (2011) 197 Cal.App.4th 1213, 1228 (*Rappaport*)). The term “liquidation value” in subdivision (b) does not refer to a distress sale price, but means “the sale price of the separate assets based upon their market value as determined by a willing and knowledgeable buyer and a willing and knowledgeable seller, neither of which is under any compulsion to buy or sell,” discounted to present value as of the date of dissociation. (*Ibid.*) *Rappaport* held that the computation of the buyout price in that case, which was supported by the analysis of one of the experts, was a reasonable application of the statutory formula in the particular circumstances even though other appraisal methods might have been adopted, since “variations ... may result from experts’ utilizing differing appraisal techniques under varying business circumstances, which we find consistent with the [revised Uniform Partnership Act] drafters’ intent to develop the term ‘buyout price’ as an independent concept.” (*Ibid.*)

partnership shall pay, or cause to be paid, in cash to the dissociated partner the amount the partnership estimates to be the buyout price and accrued interest, reduced by any offsets and accrued interest under subdivision (c). [¶] ... [¶]

“(g) The payment or tender required by subdivision (e) or (f) shall be accompanied by all of the following: [¶] (1) A statement of partnership assets and liabilities as of the date of dissociation. [¶] (2) The latest available partnership balance sheet and income statement, if any. [¶] (3) An explanation of how the estimated amount of the payment was calculated.... [¶] ... [¶]

“(i) A dissociated partner may maintain an action against the partnership ... to determine the buyout price of that partner’s interest, any offsets under subdivision (c), or other terms of the obligation to purchase. The action shall be commenced within 120 days after the partnership has tendered payment or an offer to pay or within one year after written demand for payment if no payment or offer to pay is tendered. The court shall determine the buyout price of the dissociated partner’s interest, any offset due under subdivision (c), and accrued interest, and enter judgment for any additional payment or refund.... The court may assess reasonable attorney’s fees and ... amounts the court finds equitable, against a party that the court finds acted arbitrarily, vexatiously, or not in good faith. The finding may be based on the partnership’s failure to tender payment or an offer to pay or to comply with subdivision (g).”

### C. Applicable Standard

Defendants contend that section 16701, subdivision (b), is the applicable provision for determining the buyout price of Derrick’s interest in CCS, rather than paragraph 11.6 of the Partnership Agreement. The question of applicability of section 16701 requires our consideration of how that statute functions in the context of a partnership agreement covering the same subject matter.

CCS is a general partnership. General partnerships in California are governed by the Uniform Partnership Act of 1994. (§ 16100 et seq.; the UPA) Section 16103, subdivision (a), thereof provides as follows:

“Except as otherwise provided in subdivision (b), relations among the partners and between the partners and the partnership are governed by the partnership agreement. To the extent the partnership agreement does

not otherwise provide, this chapter governs relations among the partners and between the partners and the partnership.”<sup>9</sup>

As this provision clearly articulates, the UPA sets forth the default rules that govern only “[t]o the extent the partnership agreement does not otherwise provide.” (§ 16103, subd. (a).) This means that if a partnership agreement provides for a buyout formula or a method of valuation of the withdrawing partner’s interest, the agreement controls. “The UPA allows partners to deviate from its default provisions by negotiating such deviations in a contractual partnership agreement.... [¶] Thus, parties are free to enter into their own agreements concerning the buyout of a dissociating partner’s interest. However, in the absence of such an agreement, the buyout of a departing partner’s interest in the partnership business is governed by section 16701.” (*Rappaport, supra*, 197 Cal.App.4th at p. 1225; accord, *Victor Valley Transit Authority v. Workers’ Comp. Appeals Bd.* (2000) 83 Cal.App.4th 1068, 1076; *Wood v. Gunther* (1949) 89 Cal.App.2d 718, 727.)<sup>10</sup>

Here, the parties *did* specifically agree in the Partnership Agreement how the buyout price of a withdrawing partner’s interest would be computed—namely, the method set forth in paragraph 11.6 of that agreement. Moreover, the Partnership Agreement made it clear that in the event a partner withdrew, there would be only two options available: either (1) dissolution, or (2) purchase of the withdrawing partner’s interest under paragraph 11.6. We therefore conclude that where, as here, a purchase of

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<sup>9</sup> The limited exceptions to this rule, as set forth in subdivision (b) of section 16103, are plainly not applicable to the case at hand.

<sup>10</sup> As correctly explained by one California law treatise: “The statutory provisions respecting a buyout of a dissociated partner’s interest in the partnership are not included among those that may not be eliminated or varied by the partnership agreement. Accordingly, partners may provide in the partnership agreement ... that the interest of a deceased partner may be purchased by the surviving partners for a stated sum or for an amount arrived at by a specified process or formula.” (48 Cal.Jur.3d (2004) Partnership, § 104, p. 553, citing §§ 16701, 16103, fns. omitted.)

the withdrawing partner's interest is sought in lieu of dissolution, the purchase price or valuation method is governed by paragraph 11.6 of the Partnership Agreement.

For similar reasons, defendants' argument that since they did not formally exercise the option to purchase Derrick's interest under the terms of the Partnership Agreement, they were free to utilize the price formula in section 16701 is plainly without merit. The Partnership Agreement did not allow for such formula shopping. Again, paragraph 11.1 of the Partnership Agreement stated that in the event a partner withdrew from the partnership, "the Partnership shall dissolve unless the interest in the Partnership of such Partner is purchased *as provided herein*," that is, under paragraph 11.6 (italics added). Thus, the Partnership Agreement expressly provided the sole and exclusive method of valuing the withdrawing partner's interest for purposes of a buyout, and it limited the right to pursue a buyout to the one provided in the Partnership Agreement. Because the subject of the buyout price formula was covered in the Partnership Agreement, subdivision (b) of section 16701 was inapplicable.

What of defendants' failure to serve formal written notice of exercise of the option to purchase Derrick's partnership interest within the 60-day period, as contemplated in the Partnership Agreement? If there was a failure to exercise the option in accordance with the terms of the Partnership Agreement, does that failure mean that a dissolution and winding up of CCS was required under the terms of the Partnership Agreement even though the parties did not affirmatively pursue that option? The trial court resolved this difficult dilemma by relying upon the fact that Purewal and Paw effectively *admitted* in their pleading that they had opted to proceed with a buyout under the agreement. We now turn to that aspect of the trial court's ruling.

D. Admissions in Cross-Complaint

The trial court held that Purewal and Paw "admitted" in their cross-complaint that "they elected to purchase ... Derrick's interest in the partnership in accordance with [paragraphs 11.1 through 11.14] of the Restated Partnership Agreement." Therefore, the

trial court treated such fact as established and held that defendants were estopped to deny such fact. Defendants contend this finding was in error. We disagree.

The cross-complaint alleged that Purewal and Paw were entitled “either to enforce the buy out provision in the ... partnership agreement or dissolve CCS and proceed with a winding up and dissolution.” (Cross-complaint, ¶ 33.) First, we note the two options stated are dissolution or buyout under the Partnership Agreement. Second, despite such either/or wording, elsewhere in the cross-complaint the allegations clearly indicated that a decision to proceed with a buyout under paragraph 11.6 (rather than dissolution) had been made. Paragraph 18 of the cross-complaint alleged that as a result of Derrick’s decision to withdraw from the partnership, the remaining partners (Purewal and Paw) could elect to purchase Derrick’s interest in CCS “for a purchase price to be calculated as provided in [paragraph] 11.6” of the Partnership Agreement. Paragraphs 20 and 21 of the cross-complaint alleged that since paragraph 11.6 of the Partnership Agreement called for the certified public accountant who prepared the CCS tax returns (in this case Mr. Long) to undertake the purchase price calculation, Purewal and Paw “asked Wayne Long, CPA to prepare that calculation.” According to paragraph 21 of the cross-complaint, Mr. Long calculated the purchase price under the terms of the Partnership Agreement by including Derrick’s proportionate share of future lease liability, and concluded that Derrick *owed* CCS the sum of \$116,173. The failure of Derrick to pay this amount is then listed as one of the grounds for alleged breach of contract. (Cross-complaint, ¶ 46.) Such a contractual obligation could only arise in the event that an election had been made to proceed with the buyout provision. Similarly, paragraph 49 of the cross-complaint stated in the declaratory relief cause of action that Purewal and Paw claimed “that Derrick is obligated to sell his partnership interest in CCS and pay the amount determined in paragraph 21 above.” Nothing in the prayer for relief sought dissolution, nor was it alleged that dissolution was ever elected by the partnership. It is clear from these

allegations that Purewal and Paw asserted matters that necessarily involved an election on their part to proceed with the buyout option under the Partnership Agreement.<sup>11</sup>

We therefore agree with the trial court that the allegations constituted an admission of Purewal's and Paw's decision-in-fact to proceed with the buyout option. This is not an instance of a party who has been *wronged* being allowed to allege alternative *remedies* against the wrongdoer, in which case the law generally does not force one to make an election prior to judgment. (See, e.g., 3 Witkin, Cal. Procedure (5th ed. 2008) Actions, §§ 179-202, pp. 259-282.) Rather, a partner is entitled to withdraw as a matter of *right* (§§ 16601, 16602, subd. (a), 16701, subd. (a)), and a partnership agreement cannot vary a partner's power to do so (§ 16103, subd. (b)(6)). Once a partner withdraws, it triggers a requirement that the partnership (or the remaining partners) make a reasonably prompt election of one of two courses of action—that is, to either wind-up and dissolve the affairs of the partnership, or alternatively, to purchase the partner's interest. The same is true under both the Partnership Agreement here (i.e., the 60-day time period) and the UPA. (See, e.g., § 16701, subs. (a), (e) [describing action that must be taken within 120 days]; cf., § 16701.5, subd. (a) [§ 16701 buyout rights inapplicable if dissociation was within 90 days prior to dissolution].)

Contrary to defendants' suggestion, the subject allegations did not involve a mere legal issue. The factual matter at issue was whether or not CCS—or more specifically, Purewal and Paw—had elected to purchase Derrick's interest as opposed to dissolving the partnership. The allegations of the cross-complaint highlighted above establish that

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<sup>11</sup> A further incident of their election to pursue the buyout option was an implied waiver by Purewal and Paw of the 60-day time provision for exercising that option, since the cross-complaint was served after the 60-day period. The admitted facts in the cross-complaint and pursuit of the buyout option clearly support such a waiver. (See, e.g., *Doryon v. Salant* (1977) 75 Cal.App.3d 706, 712; *Pease v. Brown* (1960) 186 Cal.App.2d 425, 429; *Panno v. Russo* (1947) 82 Cal.App.2d 408, 412; Civ. Code, § 1698, subd. (d).)

they had, *in fact*, opted to pursue a buyout. An admission of a fact in a pleading is conclusive on the pleader. (*Valerio v. Andrew Youngquist Construction* (2002) 103 Cal.App.4th 1264, 1271-74; 4 Witkin, Cal. Procedure (5th ed. 2008) Pleading, §§ 452-455, pp. 585-588.)<sup>12</sup> Consistent with our determination of this question, we note that this case was tried solely as a dispute over which buyout or valuation formula was controlling and which expert opinions should be credited, with the trial court making its findings regarding those disputed issues. Our conclusion is further supported by the finding of the trial court, as confirmed by the record before us, that there was no evidence of a dissolution or winding up of the partnership. In fact, as the trial court found, defendants were continuing the partnership business with the addition of a new partner (Dr. Peck).

For all of these reasons, we conclude that defendants have failed to show the trial court erred in its determination that paragraph 11.6 of the Partnership Agreement was the correct formula to be applied in determining the price or value of Derrick's interest.

## **II. Trial Court Reasonably Applied Buyout Provision**

Having determined that paragraph 11.6 of the Partnership Agreement was the appropriate formula for computing the buyout of Derrick's interest in CCS, we now consider whether the trial court reasonably applied the language of that provision. If it reasonably applied the applicable standard, the valuation of a partner's interest presents a factual issue subject to substantial evidence review. (*Rappaport, supra*, 197 Cal.App.4th at p. 1229.)

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<sup>12</sup> Additionally, a civil complaint serves to frame and limit the issues and to apprise the opposing party of the basis on which the plaintiff or cross-complainant seeks recovery. (*Hughes v. Western MacArthur Co.* (1987) 192 Cal.App.3d 951, 956.) The complaint or cross-complaint also limits the proof that may be submitted, because it advises the court and the adverse party of what plaintiff or cross-complainant relies on as a cause of action. (*Ibid.*)

In their appeal, defendants argue that even if paragraph 11.6 applied, the trial court erred in computing the value of Derrick’s partnership interest because it failed to include Derrick’s share of future rents due under the long-term lease as a “liability” under the terms of that price formula. The pertinent language in paragraph 11.6 stated that in computing the value of the withdrawing partner’s interest, the accountant shall determine the amount that partner would have received after considering, among other things, that “*the Partnership had paid all its debts, liabilities and other obligations to third parties ....*” Derrick responds, as he did in the trial court, that under generally accepted accounting practices applicable to businesses such as CCS, an operating lease is considered a cost of doing business for which a benefit is received each month and is therefore *not* treated as a liability or obligation. Derrick argued the buyout provision should be so construed, and the trial court agreed with Derrick. As explained below, we conclude the trial court had a reasonable basis for adopting that construction of the buyout provision in this case.

First, the trial court’s approach was reasonable based on a reading of the Partnership Agreement as a whole. Paragraph 5.2 of the Partnership Agreement stated: “the Partnership books shall be kept on a cash basis.” Paragraph 5.3 of the Partnership Agreement stated: “The accounting records shall be maintained in accordance with generally accepted accounting practices for the type of business being conducted by the Partnership.” Additionally, paragraph 11.6 specifically provided that the certified public accountant who prepared CCS’s tax returns would calculate the buyout amount.<sup>13</sup> In

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<sup>13</sup> The testimony of accounting expert, Mr. Hooper, included his opinion that CCS was using a hybrid form of generally accepted accounting practices known as “the income tax basis” of accounting. It has elements of cash basis accounting but also includes certain types of expenses or liabilities corresponding to tax deductions. Mr. Long testified that CCS used an “income tax basis” of accounting, which he said is essentially the same as a cash basis, although it would include some additional items.

light of these provisions in the Partnership Agreement, it was reasonable to infer that the meaning of terms used in paragraph 11.6 of the agreement would be consistent with (or informed by) the application of those terms under the particular accounting methodology adopted by CCS. (Civ. Code, § 1641 [whole of contract is taken together, each clause helping to interpret the other]; *id.*, §§ 1644, 1645 [technical usage or special sense of words may be applied].)

Second, where (as here) the meaning of a particular contract term is subject to different interpretations, “the court shall avoid an interpretation which will make a contract extraordinary, harsh, unjust, inequitable or which would result in absurdity ...” (*County of Marin v. Assessment Appeals Bd.* (1976) 64 Cal.App.3d 319, 325, italics omitted.) It is also well-settled that equitable principles apply in determining the respective rights of the parties in an action for a partnership accounting. (*Bates v. McTammany* (1938) 10 Cal.2d 697, 700.) We think the interpretation of the buyout provision adopted by the trial court was not only reasonable under the circumstances, but avoided a harsh or inequitable result. Since CCS did not elect to dissolve and continued to receive the benefit of use of the leased premises for carrying out the business of the partnership each month, to construe the terms of the buyout provision to include the lease as a liability allocable to Derrick would appear to be harsh, inequitable or would create a windfall in favor of CCS.

Third, the trial court’s determination that for purposes of the buyout provision, the lease was not a liability or obligation was supported by the testimony of two expert witnesses. Derrick’s accounting expert, Mr. Hooper testified that under generally accepted accounting practices applicable to and used by CCS, the multi-year lease would not be recognized as a liability because it was only treated as an obligation each month

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Derrick’s expert, Mr. Bock, agreed that CCS used cash basis accounting, or a modified version of cash-based accounting such as an income tax basis accounting.

the rent became due for use of the space being rented. That is, “operating leases” are “a cost of doing business that each month as that rental payment comes due, you receive a benefit for that space that you are renting that is equal to or in some times greater than the cost that you are incurring on a monthly basis.” He responded affirmatively when asked “are you saying that there is a wash between the burden the partnership would bear and the benefit the partnership would receive.” For these reasons, Mr. Hooper disagreed with Long’s treatment of future rental payments as a liability for which Derrick was allocated a one-third share.<sup>14</sup> Mr. Hooper testified that in computing the buyout price under paragraph 11.6 of the Partnership Agreement, the lease should not be included as a liability or obligation. The trial court expressly relied on Mr. Hooper’s analysis.

Another expert accountant, Mr. Brown, testified that under standard double-entry accounting, *even if* a lease is treated as a liability on a financial statement, one would ordinarily include as a corresponding asset the value of the leasehold (the right to use the premises for a period of time). In such case, the two entries would cancel each other out. The trial court credited this testimony as well, and concluded that the lease was an operating lease that had value to the partnership and should be recognized as *an asset*. This further supported the trial court’s conclusion that the multi-year lease was not a liability or obligation for purposes of the language in paragraph 11.6.

In conclusion, since the trial court reasonably construed the buyout provision to exclude the lease as a liability or obligation for purposes of computing the value of Derrick’s interest in the partnership, and substantial evidence supported the value arrived at by the trial court, we will affirm.

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<sup>14</sup> When Mr. Long prepared a “STATEMENT OF ASSETS, LIABILITIES AND PARTNERS’ CAPITAL” for CCS, the document did not include the lease as a liability.

**DISPOSITION**

The judgment of the trial court is affirmed. Costs are awarded to Derrick.

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Kane, J.

WE CONCUR:

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Dawson, Acting P.J.

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Franson, J.