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Confronting an ongoing debate from the outside is somewhat like arriving in a foreign land. One knows something about the human species but perhaps has never experienced the local culture or encountered its norms. What is considered trivial and what is considered important? What do we observe of the locals? What do we consider unusual that they do not observe or consider unusual of themselves? And what does this foreign culture reveal to us about our own?

The matter is complicated somewhat, perhaps, when the foreign land one is visiting previously has been colonized by our own or, like the United States and Canada, has been colonized by a common predecessor. Much is familiar. Many, if not all of the inhabitants, speak our language. We drive on the same side of the road. We eat the same foods. But much will be different, sometimes obviously and sometimes more subtly. And the

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proximity, indeed the intermingling, of two cultures makes aspects of each all the more striking.

This analogy occurs to me as particularly apt as I encounter, really for the first time, the debate over the Revised Uniform Partnership Act (RUPA) and partnership fiduciary law in the context of this excellent symposium. I come, of course, from the land of corporate law which, like partnership law, has a colonial antecedent in fiduciary obligation. And much like the caricatured American tourist, I will undoubtedly be conspicuous in my bad manners and cultural arrogance. But, like that caricature (and really quite like myself as well), I will be direct. For what I find in this foreign land is that its Emperor, the centerpiece of the debate over RUPA, is stark naked. This debate is, I shall argue, a debate about nothing, because it has entirely ignored, except superficially, what is important.

Having undoubtedly already ruffled some feathers, I shall be more specific. There are two points at which the debate fails to engage its substance. Each point is strikingly characterized by the way in which metaphors, labels, and just plain rhetoric substitute for any meaningful analysis.[1] The first point is the broadly structural normative argument that has been characterized as the debate between contractarianism and the fiduciary approach. In evaluating this issue, I feel much like a visitor from a former colonial power, encountering a familiar form that has completely lost its meaning. The second point is in the fight over RUPA's fiduciary provisions. Here I feel like a visitor from a sister colony, encountering a common norm that has grown differently when rooted in different soil.

My purpose in evaluating this debate is not to advocate a particular point of view, although that will undoubtedly be a byproduct (and it is no secret where my sympathies lie). Rather, it is to evaluate the extent to which the argument has failed to go beyond the level of rhetoric and metaphor to grapple with the real issues and to suggest some different ways of thinking about fiduciary issues in the context of this very important discussion. My conclusion is that the debate largely has missed the point. With a camera

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1. There are two significant exceptions. The first exception is the work of Professor Allan Vestal, which is cited throughout this essay. Professor Vestal's work identifies and argues from some of the core values underlying fiduciary obligation. However, I think it is fair to say that Professor Vestal does not quite get to the bottom of the core values. The other exception is the work of Professor Larry Ribstein, which although sometimes over-relying on the contract metaphor, consistently has been frank about Professor Ribstein's view of the importance of efficiency values purportedly furthered by the contractarian model. However, Professor Ribstein has oversimplified matters largely by failing to recognize the importance of other values in pursuing that ultimate goal. It is important for all business lawyers to remember that Adam Smith wrote not only *The Wealth of Nations*; he also wrote *The Theory of Moral Sentiments*.

slung around my neck and a loud Hawaiian print shirt on my back, let me then go exploring.

I. The Complete Irrelevance of the Contractarian/Fiduciary Debate

The debate over RUPA consistently has been characterized as one over contractarianism versus some "other" model, usually described as the fiduciary or mandatory model.[2] Drawing on the history of the predecessor Uniform Partnership Act (UPA), which sought to provide a default contract for those persons who found themselves, whether intentionally or not, in partnerships without formalized agreements, a significant question concerning the drafting of RUPA appears to be the extent to which the goal was to provide anything more than that — a simple default contract. Largely forgotten, however, is the origin of the partnership form of business in common law and before that in observed human behavior.[3] Rather, much of the debate seems to assume that partnership is a statutory creature whose birth dates to the drafting of the UPA.[4] And not only is partnership a statutory creature; it is a statutory creature whose principal purpose is to set out a form contract. Consequently, the partnership is a creature of contract, and the only issue worth discussing (other than its specific terms) is the extent to which the state may legitimately prescribe terms for those who choose to vary them. Because the starting point of discussion is, however, that partnerships are contractual, and because contract law has developed on the underlying value of freedom of contract, proponents of state-mandated terms bear a heavy burden of proof. In summary, partnerships are contractual, people are free to arrange their own contracts, and the state should keep out beyond the extent to which it regulates other contracts. Q.E.D.

The argument is as understandable as its origins are plain, and this is where I feel like the visitor from the colonial power. The contractarian/fiduciary or mandatory/enabling argument began in corporate law. However, the argument's origins in corporate law were not in legal conclusions, but rather in behavioral analysis. Starting with a set of assumptions about human motivations and conditions under which they flourish, Fama[5] and

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2. Allan W. Vestal, *Fundamental Contractarian Error in the Revised Uniform Partnership Act of 1992*, 73 B.U. L. REV. 523, 523-24 (1993).

3. *See id.* at 532, 537-45.

4. The overstatement in the text is only a little unfair. Of course all of the *Future of the Unincorporated Firm* Symposium participants know something about the origins of partnership law. They simply write as if they do not, and that appears to have had a significant impact on the course of the debate.

5. Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 289 (1980).

Jensen and Meckling[6] argued that the appropriate way to think about the corporate legal fiction was as contractual. To a large extent, this analysis was more descriptive than normative and merely offered a way of thinking about the ways in which real persons underlying the juridical person related to one another. It remained for legal scholars with varying degrees of economic, psychological, sociological, and philosophical sophistication to take the metaphor and incorporate it into the normative enterprise of legal criticism. Although these scholars sometimes permitted the metaphor to replace analysis, more often it served as a shorthand for the behavioral assumptions upon the basis of which these scholars criticized corporate law. Because the form we call the corporation is not, in legal reality, a contract in the more typical way that a partnership agreement is, however, the contractual metaphor rarely took on a life of its own.[7]

The corporation as contract metaphor is one that I have consistently rejected, less because of its descriptive power (which it admittedly has) than because of the assumptions said to underlie it and the norms that were invariably (although not inevitably) attached to it. But the use to which the contractual notion has been put in the RUPA debate borders on the absurd. The contractual metaphor has been used as the ground on which to question the legitimacy of fiduciary obligation in partnerships at all.

Again, the starting point of the debate is that partnerships are contractual in nature. This is sometimes explicitly stated, but is almost invariably assumed. This assumption is evident from the almost universal description of fiduciary duties as "gap fillers," again taken from the context of corporate law. Gap-fillers to what? To the contract that is the partnership, of course. Once one begins from the premise that a relationship is contractual, it is easy (although, as I and others have argued, not inevitable) to assume that the dominant value is contractual freedom. Yet, to paraphrase Justice Frankfurter: to say that a relationship is contractual only begins analysis; it gives direction to further inquiry.[8] What is the purpose of permitting this particular contractual relationship to exist? What are the norms to be served, and the background assumptions upon which they are built? These are questions that appear to be answered superficially, if at all, in the current partnership debate.

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6. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Management Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308-10 (1976).

7. The metaphor has, in my view, sometimes been taken to extremes. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 15-25 (1991); Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarian*, 65 WASH. L. REV. 1, 7-18 (1990); *see also* Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403, 1411-20 (1985) (providing excellent critique of excesses of this theory).

8. SEC v. Chenery Corp., 318 U.S. 80, 85-86 (1943).

Before dealing with these questions in the context of that debate, however, there is a fundamental point to be made. The issue of the nature of partnership often has been described as one of a contract model versus a fiduciary model. The dominant conclusion that partnership is contractual appears to be taken to exclude the fiduciary. This is particularly evident in the Reporter's Comments from RUPA. But, if I may be so direct, this is a ridiculous conclusion. *All fiduciary relationships originate in some form of consent, and nearly all of those that involve property or commerce are contractual.* Trustees and agents, for example, agree to serve as such or, in the case of the latter, at least consent to enter the relationship that carries with it the agency label. And, typically, trustees and agents expect to be paid. Although they may well expect a salary in contrast to partners who share profits, that hardly eliminates the self-interest of their motivation in consenting to the relationship. Moreover, agents often are compensated in ways that place their own interests in direct conflict with the interests of their principals. That conflict does not make them any less agents. Thus, the fact that the partnership relationship is essentially contractual says absolutely nothing about the obligations and consequences of that relationship, other than that it is voluntary. To conclude anything further is utter nonsense.

A perfect example of the conclusory nature of these discussions is provided by Professor Hynes.[9] In discussing the nature of partnership, he juxtaposes the options as "simply a contract," with its implicit promise of flexibility, or as "something more than a contract, involving inherent fiduciary duties that constitute a mandatory core."[10] Before concluding, with absolutely no analysis, that "[t]he partnership relationship is most understandably viewed as a contractual relationship in all of its respects,"[11] he describes the alternative as approaching a natural-law perspective.

One can, perhaps, understand the puzzlement of an outsider. What, for example, is "simply a contract"? Granted, we all took a course in law school with that name, and there are contract treatises on our library shelves. But does Professor Hynes, or anybody else for that matter, really believe that there is a simple thing called "contract" that permits parties to do whatever they want, short of fraud or crime? Even the simplest of contracts carries with it myriad restrictions, not only from within contract doctrine itself, but also from other forms of law and regulation — from constitutional prohibitions on our freedom to transact, to the entire corpus of property law that defines our right to transact in the res of the contract, to employment and

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9. J. Dennis Hynes, *Fiduciary Duties and RUPA: An Inquiry into Freedom of Contract*, 58 LAW & CONTEMP. PROBS. 29 (Spring 1995).

10. *Id.* at 38-39.

11. *Id.*

labor laws that regulate the way we contract with people for their services, to family law that restricts the manner in which we can contract with specified others.[12] If there is no such thing as "simply a contract," then what does it mean to contrast it with "more than a contract," involving fiduciary duties? Surely when a business corporation enters into a simple employment contract with an officer, it expects to rely on the fiduciary obligations implicit in that relationship. When I employ my stockbroker to make purchases on my behalf, I assume the same. When a bank trust department accepts, for a fee, the management of an estate, the testator surely expects that the bank will behave in a fiduciary manner towards the estate beneficiaries. Whether supplemented by regulation or common law, law or equity, it ought to be abundantly clear that there is no such thing as "simply a contract" as Professor Hynes describes. Nor does Professor Hynes ever tell us *why* a partnership is "most understandably viewed" as contractual. Without such an explanation it is difficult to see what purpose, if any, this description serves.

Moreover, concluding that the doctrine of fiduciary duty has a moral component does not necessarily relegate it to the somewhat unpopular realm of natural law. There are other moral theories. Professor Hynes need not struggle with Aquinas, or even Kant. He could simply read Adam Smith.[13] Finally, as I will later discuss, if one is somehow offended by the moral aspects of the law, there are a number of functional arguments that support the inclusion of a strong fiduciary doctrine in partnership law. All of this, then, is to say that the debate is advanced not at all by referring to a partnership as "simply a contract," a phrase that not only is analytically problematic, but also that is descriptive of nothing.

II. (Completely) Missing the Point About Fiduciary Duty, or the Power of Rhetoric over Reason

The debate over RUPA's fiduciary provisions apparently has generated the kind of emotional responses normally reserved for religious or political debate. And like the former (and increasingly the latter), the debate has devolved into oversimplifications and rhetorical flourishes that obscure analysis. While this may be appropriate, and even desirable, when one is dealing in revealed truth (even the rationalist Aquinas had his limits), it is disastrous for legal analysis. And disastrous is precisely what the fiduciary provisions of RUPA turn out to be.

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12. Dean Weidner appears to appreciate this point, at least as to the mandatory rules provided within contract doctrine itself. *See* Donald J. Weidner, *RUPA and Fiduciary Duty: The Texture of a Relationship*, 58 LAW & CONTEMP. PROBS. 81, 97 (Spring 1995).

13. *See infra* notes 50-51 and accompanying text.

There are several places where the drafters and debaters took a wrong turn. The first, and perhaps most surprising error, is doctrinal. Although there is some evidence that the drafters and debaters looked somewhat beyond case rhetoric, two things are apparent: they did not look very carefully, and they did not look beyond the narrow field of partnership law. Had they done so, they would have found that most fiduciary applications today permit some of the self-interested conduct now provided by RUPA, but backstopped by a requirement of fairness. Fairness — and not self-abnegation — is the hallmark of the modern fiduciary. The interpretation of fiduciary duty in the partnership context as requiring the standard of *Meinhard's*[14] rhetoric set up for failure the continuation of a meaningful fiduciary obligation in the age of self-interest.

A second failing is attributable to the level of sophistication of the policy debate. Characterized, on the one hand, by Professor Hynes's completely unsubstantiated empirical assertions and, on the other hand, by vague claims for the value of loyalty, the death knell for fiduciary obligation was sounded, perhaps unintentionally, by Dean Weidner. His characterization of the values at stake as "libertarianism" versus "paternalism" almost inevitably doomed the policy based on the latter in a nation whose very founding documents, not to mention many of its laws, literature, and customs, proclaim the moral primacy of individual autonomy. As I will argue, there are purely instrumental reasons supporting a strong notion of fiduciary duty, reasons that stem from the very efficiency concerns trumpeted by Professors Hynes and Ribstein, and which can be resolved only by hard empirical evidence (a task the drafting committee evidently declined to undertake).

Moreover, the moral choices are no more limited to "libertarianism" and "paternalism" than they are to Professor Hynes's target of natural law. The misused phrase "paternalism" in particular deals solely with choices that we make for others. The phrase excludes the possibility that we, as a society, may have a legitimate interest in the way business relationships are structured and that this interest is reflected in our rules governing that relationship for reasons having nothing to do with the welfare of the particular parties, although the rules clearly affect their welfare. Among the reasons we regulate marriage, for example, is to preserve a particular vision of a social institution at least as much as for the protection of the parties, a fact nowhere clearer than in recent debates over same-sex marriages. When, then, Judge Cardozo proclaims at the conclusion of his introductory paragraphs in *Meinhard* that "the two were in it jointly, for better or for worse,"[15] he is saying as much about the preservation of a social institution as he is about

14. Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928).

15. *Id.* at 546.

a business contract. A more subtle understanding of the values undergirding classic fiduciary obligation might have enriched the debate and perhaps have resulted in better policy. For notwithstanding Dean Weidner's hope that the RUPA "compromise" is a reasonable one,[16] I will show that RUPA has destroyed any semblance of fiduciary obligation.

A. Fiduciary Doctrine: Fact, Not Fiction

Despite the sweeping rhetoric of Judge Cardozo's opinion in *Meinhard* and other expressions of fiduciary duty, and no matter how much I and others may mourn its passing, the reality of modern fiduciary doctrine nowhere near approaches its rhetoric. As I have extensively detailed elsewhere,[17] fiduciary obligation as applied in corporate law, no matter how ringing the rhetoric or how purple the prose, takes substantial account of self-interest in its doctrines. In particular, corporate law has two fiduciary variations for application in contexts similar to that of partnership. Moreover, even the fount of fiduciary obligation — trust law — modifies classic fiduciary obligation to carve out an area of fiduciary self-interest. The laws dealing with one of the ultimate fiduciary relationships, marriage, and particularly antenuptial and settlement agreements, are generally governed by some form of a fairness test rather than self-abnegation. Finally, even partnership law, as applied in the cases, relies on a fairness test to govern fiduciary self-dealing in appropriate cases.

Corporate law has grappled with fiduciary issues in a variety of contexts and within a structure that is significantly more complicated than that of general partnership law. One might have expected, therefore, that a look at corporate fiduciary law could have been helpful to RUPA's drafters. Surprisingly, it appears that the drafters completely ignored corporate law, thus impoverishing the debate and resulting in unsatisfactory model legislation. Despite this, I will show how corporate law can shed light on a sensible interpretation of RUPA's fiduciary provisions (albeit not one apparently contemplated by the drafters) in a manner consistent with the professed intentions of the drafters.

It is clear from the RUPA debate that a major concern of all involved was the obvious fact that each partner has a legitimate self-interest in the partnership and its business. The question then arises how partners can be expected to function as fiduciaries, "renouncing all thought of self," when

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16. Donald J. Weidner & John W. Larson, *The Revised Uniform Partnership Act: The Reporters' Overview*, 49 BUS. LAW. 1, 28 (1993).

17. Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE L.J. 425, 426-27 (1993) [hereinafter Mitchell, *Fairness and Trust*]; Lawrence E. Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675, 1681-82, 1688-92 (1990) [hereinafter Mitchell, *Death of Fiduciary Duty*].

self-interest led them to the partnership in the first place. The RUPA answer is a blanket permission to act in a self-interested manner, thus, as Professor Vestal and others have observed, turning cooperating venturers into adversaries.

Such a stark approach was completely unnecessary. Corporate law has faced the same problem. One context in which corporate law has reached a reasonable compromise is in that of the fiduciary obligations of controlling stockholders. Like partners, controlling stockholders have a legitimate financial interest in the enterprise, one for which they paid and from which they expect to reap a reward. Unlike partners, however, the power of such a stockholder is not the simple consequence of stockholding, as it is of having the status of a general partner. Power is, rather, a consequence of having enough stock to control the corporate machinery. And in the corporation, unlike the mutual agency that is the partnership, control is all or nothing. Once a controlling stockholder achieves that status, she, by definition, always wins. She wins by controlling machinery, the board of directors, put in place to serve as the stockholders' fiduciary. The completely vulnerable position in which this puts minority stockholders leads to the controlling stockholder's fiduciary duty.

But the same problem presents itself. If the controlling stockholder is to act as a fiduciary, if it is to act in a self-abnegating manner, how is it to fulfill its own legitimate financial interest in becoming a stockholder in the first place? And who in their right mind would risk becoming a controlling stockholder if no reward could be reaped?

The simple answer is that self-abnegation is not required. Rather, a more subtle variation of fiduciary obligation is applied in the form of a two-part inquiry. The first part requires a determination of whether self-dealing took place at all. Courts look not only at the benefit received by the fiduciary controlling stockholder in answering this question; they also look at whether the beneficiary minority stockholders suffered detriment as a result. Only if the transaction at issue meets both parts of the test — benefit to fiduciary *and* detriment to beneficiary — is the next inquiry made. The second inquiry asks whether the transaction was fair despite the self-dealing.

A classic example of the application of this test and the context for which it was designed is provided by the famous Delaware case of *Sinclair Oil Corp. v. Levien*,[18] in which minority stockholders accused the controlling parent of violating its fiduciary duty by causing the corporation to declare substantial dividends.[19] The court held that the parent did not violate its fiduciary duty because both the controlling and minority stockholders received

18. 280 A.2d 717 (Del. 1971).

19. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720-21 (Del. 1971).

the proportionate dividends to which they were entitled, and thus the fairness test was not applied.[20] Conversely, in *Burton v. Exxon Corp.*,[21] the court required application of the fairness test (and found fairness) when the controlling stockholder declared dividends on its preferred stock, but not on the common stock held by the minority. Because the fiduciary received something to its benefit and the detriment of the minority, an evaluation of fiduciary fealty required further inquiry.[22] It should be obvious that the fairness test will be required whenever the fiduciary contracts with the corporation.[23]

Although in the eyes of a fiduciary traditionalist the test is not beyond criticism (at least as applied),[24] it has quite a respectable pedigree, tracing back at least as far as Justice Douglas's opinion in *Pepper v. Litton*,[25] an opinion that competes with *Meinhard* for the sweep of its language (and one in which, incidentally, the Supreme Court was unanimous). Writing for the Court, Justice Douglas noted that:

> [A fiduciary] cannot use his power for his personal advantage *and to the detriment of the stockholders* . . . . For that power is at all times subject to the equitable limitation that it may not be exercised for the aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment of the *cestuis*.[26]

Thus, detriment to the beneficiary has long been an accepted part of fiduciary breach, a fact that might have been discernible to the participants in the RUPA debate and that might have led to a different outcome if the analysis had not been obscured by fiduciary rhetoric.

It is possible to read RUPA's fiduciary provisions as establishing this benefit/detriment test. Section 404(e) permits a partner to further his own interest without violating a duty under the partnership act or agreement.[27] On its face, this provision either means nothing or is internally inconsistent with Section 404(b)(2).[28] The provision may mean nothing, for no strain of law

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20. *Id.* at 722.

21. 583 F. Supp. 405 (S.D.N.Y. 1984).

22. Burton v. Exxon Corp., 583 F. Supp. 405, 420 (S.D.N.Y. 1984).

23. Mitchell, *Fairness and Trust*, *supra* note 17, at 481-82. The reason, of course, is that the contractual consideration will not be the same on both sides, and thus the fiduciary will always receive something the beneficiary does not receive. This seems to be the reason that the fairness test (or its statutory surrogate) always is applied in interested director transactions. *See, e.g.*, DEL. CODE ANN. tit. 8, § 144 (1996); Marciano v. Nakash, 535 A.2d 400, 404 (Del. 1987).

24. Mitchell, *Fairness and Trust*, *supra* note 17, at 471-72.

25. 308 U.S. 295 (1939).

26. Pepper v. Litton, 308 U.S. 295, 311 (1939) (emphasis added).

27. REVISED UNIF. PARTNERSHIP ACT (1994) (RUPA) § 404(e), 6 U.L.A. 58 (1995).

28. *Id.* § 404(b)(2).

of which I am aware prohibits a partner, simply because he holds that status, from furthering his own interest *unless* he does so by dealing adversely or in competition with (and therefore to the detriment of) the partnership. If these are the situations contemplated by Section 404(e), then that Section is facially inconsistent with Section 404(b)(2), which prohibits partners from dealing adversely or in competition with the partnership. Assuming, reasonably I think, that the drafters could not have meant Section 404(e) to be meaningless, it can be reconciled with Section 404(b)(2) by interpreting them together as a restatement of the benefit/detriment test: A partner breaches no statutory or contractual duty to the partnership or its partners by engaging in transactions with, or in competition with, the partnership, *unless* such transaction or competition results in detriment to the partnership or to the other partners.

Thus, statutory inconsistency can be eliminated and partnership fiduciary duty can be tied into a long-standing, rich body of law without any stretch of statutory language. Indeed, the use of the word "adverse" in Section 404(b)(2) but not in Section 404(e) further supports this interpretation. The fact that the drafters themselves undoubtedly were familiar with this body of law suggests, although perhaps weakly, that this model of fiduciary obligation at least subtly informed their drafting.

The remaining question under such an interpretation would be the consequence of finding that a partner's self-interested conduct resulted in detriment to the partnership and to the other partners. The most reasonable statutory interpretation, in light of the absolute prohibition articulated in the statute, is that such a finding concludes the issue of breach, with traditional remedies such as a constructive trust or disgorgement imposed upon the wayward partner. An alternative interpretation, although one with no statutory support, would be that such a finding merely invokes a judicial fairness test like the one applied in corporate law. This approach, I regret to say, appears more consistent with the drafters' intent to restrict fiduciary obligation. On the other hand, it would be inconsistent with the drafters' desire to limit partnership litigation; after all, prohibitions are much easier to apply. But it is not my purpose here to explore these alternative interpretations thoroughly. Instead, I offer them as a way of highlighting the lack of subtlety and nuance generally employed in the RUPA drafting and policy debate.

But even this compromise alternative need not have been accepted all or nothing. Corporate law provides other mechanisms that could be used either with or in place of the benefit/detriment test. For example, at least in partnerships of more than two members, the interested director approach could be used. While also subject to criticism,[29] this approach sets out statutory procedural requisites that must be followed by a corporation's board of

29. Mitchell, *Fairness and Trust*, *supra* note 17, at 440-42.

directors before permitting one of their own to do business with the corporation. Whereas the decentralized management of the general partnership would require some procedural modifications, the idea of some form of disinterested approval coupled with a fairness or reasonableness standard presents a compromise between self-abnegation and the complete elimination of fiduciary obligation. Again, it seems astonishing that such a possibility was entirely overlooked in the RUPA debate.

A final approach developed by corporate law (or actually a series of variations on the central approach) applies in a context like that of the controlling stockholder (and thus more like the partnership) of the close corporation. The failure to look to this body of law in the RUPA debate is particularly ironic because close corporation law itself expressly is an adaptation of partnership law, and thus the evolution of partnership rules in a different but related field could have been instructive. Although the law has devolved to a point where it no longer approaches classic fiduciary law,[30] the tests developed by courts and later legislatures to deal with the problems of minority stockholder oppression in close corporations provide another set of alternatives that might have avoided the wholesale abrogation of partnership fiduciary duty and could have been tailored to deal with the specific concerns of the advocates of party autonomy. Obviously one of the main corporate characteristics leading to the need to deal with oppression — relative indissolubility — is not present in the general partnership, but partnership dissolution is not costless and therefore, as a practical matter, not always readily available. Moreover, some of the problems dealt with by the close corporation laws, like disparate treatment of stockholders resulting from dealings with the corporation (e.g., excessive salaries) are also issues that can arise in the partnership setting.

B. Fiduciary Policy: Beyond Labels

If the doctrinal battles over RUPA's fiduciary provisions are characterized by a distinct lack of imagination, the policy debates are notable for their stunning failure to move beyond labels and metaphor. Although Dean Weidner's unfortunate characterization of the argument as one of libertarianism versus paternalism may have contributed to this tendency,[31] the commentators appear largely to have been unable to move beyond gross and unsubstantiated assertions of efficiency and fairness. I will briefly comment on the former and spend the balance of this Article exploring the various policy bases for strong fiduciary obligation, most of which have been ignored in this debate.

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30. Mitchell, *Death of Fiduciary Duty*, *supra* note 17, at 1691-92.

31. Dean Weidner's understanding of the issues appears to be more nuanced. Weidner, *supra* note 12, at 81.

1. Efficiency Requires Proof, Not Assertions

There is a fashion in law and economics, rapidly fading except for a few die-hard advocates,[32] to assert that economically efficient outcomes are reached by agreement of the parties (whose agreement in fact proves economic efficiency)[33] who know their own interests, and that state interference with this agreement is therefore likely to be inefficient. It is not that some parties will not in fact be hurt by judicial noninterference and that the rule of efficiency is invariant. Rather, the advocates of efficiency believe that judicial interference decreases overall welfare so that it is unreasonable (inefficient) to tailor laws to protect such parties.

Although law and economics practitioners are coming to realize the limitations of this theory, as well as to explore in more detail the conditions under which it may be true, it is critically important to note that certain conditions must in fact be true in order for the proposition to hold. Among the conditions are the requirements that the parties have relatively equal information, or access thereto, and have relatively equal bargaining power, and that each of the parties expects the others to pursue their respective interests.

In the RUPA debate, these presumed conditions are transformed into factual assertions. Professor Hynes, for example, makes heroic assertions of fact without the slightest supporting evidence as illustrated by the following passage:

> Persons entering into a partnership relationship ordinarily bargain from an approximately equal position, an equality created by the fact that each party typically has something of near-equal value to offer the other. This is the reason partnership status is being offered by one party and sought by the other.[34]

There are at least three factual assertions in this brief passage alone, not one of which is necessarily obvious or supported by evidence. It may be the case that persons negotiating a partnership bargain from equality, but this is not something that Professor Hynes knows. Moreover, equality itself is a rather fuzzy concept. Even assuming some form of bargaining equality between the parties, we need to identify the respects in which such equality is legally relevant. Professor Hynes seems to identify this in the next clause

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32. *Compare* William W. Bratton, *Game Theory and the Restoration of Honor to Corporate Law's Duty of Loyalty*, *in* PROGRESSIVE CORPORATE LAW 139, 146-48 (Lawrence E. Mitchell ed., 1995), *and* Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 758-66 (1995), *with* Larry Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537 (1997).

33. For an explanation, see Richard A. Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487, 491-97 (1980).

34. Hynes, *supra* note 9, at 40.

(and factual assertion), that "typically" each party offers the other something of "near equal value." Thus, the relevant equality is that of consideration for the partnership enterprise. But valuation itself is a notoriously elusive concept and depends critically not just on parties' current information, but on their ability to foresee future events as well.[35] Value depends on the future returns to be generated by a partner's contribution. Partners may have different information with which to predict these returns. Or, giving a different sense to equality, partners may have different abilities to process and evaluate the same information. One might say, in response to this last point — that's too bad — that capitalism is designed to permit the more talented to triumph over the less so. But when one is dealing with a cooperative business enterprise, the longevity and stability of which is based quite centrally on the relationship of the parties, it seems reasonable to consider more seriously the reality of partners' equality before simply asserting it.

Finally, Professor Hynes asserts that this equality of consideration is what leads the partners to enter into the relationship in the first place. This assertion is neither logically obvious nor factually supported. The logic again depends upon the meaning of equality. The paradigm case contemplated by Professor Hynes's assertion is one in which two partners contribute an equal amount of money. That, I submit, is the only case in which one can unequivocally assert that the partners have contributed something of equal value. But instinct and experience (and only that — I have no empirical support) suggest that this is not the typical case. In the typical case, the parties will offer each other something different, including unique assets such as intellectual property or skills that may not yet be tested. One assumes that each party believes the other to be offering something of equal value. But their agreement will be efficient only if the parties are correct.

Finally, Professor Hynes has no way of knowing that most partnerships are formed because of what each party has to offer the other. Drawing only from the admittedly small sample of reported cases and making no attempt to quantify, I have explored elsewhere the variety of ways in which close corporations come into being.[36] Certainly, family relationships, inheritances, and friendships make strong and frequent appearances in the cases, suggesting that the commercial joint venture paradigm offered as typical by Professor Hynes is only one of many possibilities. Without empirical verification, we simply do not know. To change literally hundreds of years of partnership law would itself require fulfillment of a substantial burden of

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35. This is a different aspect of the importance of the foreseeability concept that Professor Vestal describes.

36. Lawrence E. Mitchell, *Professional Responsibility and the Close Corporation: Toward a Realistic Ethic*, 74 CORNELL L. REV. 466, 486-91 (1989).

proof.[37] To do so on the basis of unsubstantiated empirical assertions is irresponsible.

Of course, one suspects that efficiency is a bit of a subterfuge. For regardless of the factual accuracy of Professor Hynes's assertions, RUPA's drafters quite consciously assumed as their model the larger sophisticated partnership, in which all parties are represented by counsel. One wonders why, given the policy of contractual freedom, one even needs partnership law to govern such people (other than as to their obligations to creditors and third parties). Rather than gutting much of partnership law to accommodate such partnerships, a better approach might have been to draft a statute governing inadvertent partnerships and the partnerships of less sophisticated people, perhaps unrepresented by counsel, and let the new paradigm partnerships opt out entirely. One suspects that RUPA was drafted more to benefit lawyers by giving them a fail-safe backstop than to benefit the parties themselves. Moreover, by severely limiting fiduciary obligation, RUPA benefits sophisticated lawyers and their clients, not only allowing them to take advantage of the weaker parties, but providing them with winning arguments in the case of ambiguous drafting. Efficiency, as used in this debate, is a label for the protection of the wealthy and for the disadvantaging of the relatively weak.

2. *The Values of Fiduciary Duty*

Entirely apart from the question of efficiency, and apart from the quality and persuasiveness of arguments in favor of the policy, is the nature and function of fiduciary obligation. The argument supporting a strong fiduciary obligation is couched in terms of some kind of ill-defined individual fairness or justice, concepts that are used synonymously,[38] but that I believe to be distinctly different.[39] The notable aspect of this argument is that it is articulated as favoring the protection of the individual, in contrast to the utilitarian and therefore more socially oriented value of efficiency.

Characterizing the argument this way almost inevitably dooms fiduciary duty for a number of reasons. First, unlike efficiency, fiduciary duty is difficult (or at least more difficult) to model mathematically in economic terms, although attempts have been made.[40] It thus lacks some of the mathematical elegance and its accompanying sense of inevitability that can

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37. *See* Vestal, *supra* note 2, at 536.

38. *See generally* LAWRENCE E. MITCHELL, THE SELFISHNESS SURPLUS (forthcoming 1998).

39. *Id.*

40. *See generally* 1 KEN BINMORE, GAME THEORY AND THE SOCIAL CONTRACT: PLAYING FAIR (1994).

be conferred on the efficiency argument. Moreover, the fairness argument, because of its rooting in moral theory, can and often is characterized as fuzzy, debatable, and uncertain in an era of moral relativism, and critics of the doctrine, unschooled in moral and ethical theory, make little attempt to understand its deeper underpinnings.[41] In order to be persuasive, then, arguments supporting the imposition of strong fiduciary duty must be much more specific in identifying the social and individual benefits to be derived.

a. A Functional Approach to Fiduciary Duty

One way of providing such an argument is to look at the social benefits conferred by fiduciary obligation. To evaluate this, it might be useful to imagine the desirable characteristics of partnerships, by which I mean the qualities that are likely to make them successful. Common sense tells us that chief among these must be a sense of permanence and stability in the partnership, a feeling that the partnership's longevity is such that long-term business decisions and individual devotion to the partnership's affairs can rationally be undertaken even by self-interested economic actors who might otherwise flit among profitable opportunities. Particularly in light of the relative freedom of partnership dissolution, assurances of stability are important. It is no accident, for example, that as divorce laws have liberalized, the rate of divorce has substantially increased.

No law or contract is likely to substitute for the trust and mutual regard of the parties. But law can be used in a way that will help to foster the development of trust and make it more rational.[42] Trust is a device that, among other things, reduces uncertainty in an enormously complex world. Much is uncertain at the time parties enter into a partnership relationship. Although each makes assumptions or predictions, foresight is hardly perfect. Moreover, although presumably the parties trust each other to keep their basic agreement or they would likely not enter into business together in the first place,[43] they have no way of assuring their partner's fidelity over time. Finally, each may well have different interpretations of their mutual agreement when problems arise.

Fiduciary duty provides a means of ameliorating these difficulties by making trust rational. In the first place, fiduciary duty gives each party a reason to trust the other in a long-term relationship of unforeseeable conse-

41. See, for example, Professor Hynes's characterization of fiduciary duty as approaching natural law. Hynes, *supra* note 9, at 39.

42. *See generally* Lawrence E. Mitchell, *Trust. Contract. Process.*, *in* PROGRESSIVE CORPORATE LAW, *supra* note 32 (exploring this argument in much greater detail).

43. *Id.* at 191-93.

quences because, backed by legal sanctions, it requires each party to act as if it were trustworthy, even if circumstances incline the party to behave badly. Moreover, by instructing the partners as to the type of behavior that is required of them, it has the potential to forestall legal disputes by giving the parties an incentive to negotiate. Just as Professors Hynes and Ribstein are critical of the uncertainties that the prospect of adjudication imports into partnerships, that prospect also has creative (and efficiency-enhancing) uses. By discouraging litigation by making it unattractive, it makes negotiation and compromise a more rational strategy — one that has the potential to contribute to partnership stability. Only a person who was rigorously insistent (and who could coherently defend) each person's absolute right to take advantage of others could object to such a result. And those who would object by arguing that such advantage-taking, rent-seeking, or profit-maximizing is socially advantageous are required to move the fiduciary status quo by proving that greater wealth is created by opportunism than long-term business stability. This is an argument that requires factual support rather than a rehashing of simple neoclassical economic theory.

Thus seen, fiduciary duty has a distinct economic function. By providing a mechanism to assure business stability, fiduciary duty permits longer-term management than would be rational with a combination of free dissolution and unbounded self-interest. Not only does this stability contribute to the welfare of the particular enterprise, but it also has the potential to reduce the dislocations that occur when an operating business falls apart. These dislocations, for example, were a major part of the traditional reluctance to dissolve profitable corporations,[44] and they are equally problematic in the partnership context. Although creditors may eventually be paid and employees compensated (and hopefully reemployed), the delays and uncertainties attendant upon partnership dissolutions have a cost — in particular, a cost which can be amplified by heavily-litigated disputes that may attend dissolution following opportunistic party conduct. Again, the cases are quite revealing as to the emotional turmoil that can result when partners feel mistreated by one another. And again, the analogy to marriage is apt.

One solution that is unattractive for a variety of reasons (not the least of which is the unlimited liability of general partners) would be to restrict partnership dissolution. A preferable solution, and the one traditionally chosen by partnership law, is to provide a legal incentive for the parties to get along by forgoing opportunistic conduct. This solution is, of course, fiduciary duty.

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44. *See* WILLIAM L. CARY & MELVIN ARON EISENBERG, CASES AND MATERIALS ON CORPORATIONS 444-50 (6th ed. 1988) (noting that fact of corporate limited liability amplifies reluctance to dissolve).

Viewed in this way, fiduciary obligation is neither principally about individual justice nor about the infiltration of some ill-defined (and presumably unfashionable) moral theory into partnership law. Fiduciary duty is, instead, a tool that is designed to serve the very same goals of social efficiency as the more laissez-faire diminution of fiduciary duty that arguably facilitates freedom of contract. In these terms, the relevant question is which approach better serves efficiency goals. It is a question that must be answered by fact, not theory. As far as I can tell, nobody has amassed the facts necessary to answer the question.

One remaining argument from the conventional (neoclassical) fiduciary argument proceeds as follows: *If* fiduciary protection were a desirable characteristic of partnerships, we should see parties including fiduciary protection in their contracts. There are several answers to this — each of which I find conclusive.

The first and simplest answer is that the parties have never had to contract for fiduciary protections. Partnership and its progenitor, agency doctrine, have through long history and usage been filled with the rhetoric, if not always the reality, of strong fiduciary obligation. Because fiduciary duty evolved so thoroughly in the law (another reason, in neoclassical parlance, to assume its validity), there never would have been any reason for parties to develop contractual fiduciary protections. Nor would there have been any need to include a fiduciary provision in the UPA in light of that long history and well-developed case law, unless the statute's drafters intended to abrogate the common law. There is nothing at all remarkable in the absence of such a statutory provision, and contorted efforts to make the accounting provision do the work of fiduciary duty[45] are sadly misguided and damaging to the intellectual integrity of the argument in support of fiduciary obligation.

A second reason why the parties might not include fiduciary protection in their contracts goes to the question of self-interest and, in particular, the reality that most parties do not consider broader social interests when they enter into business relationships. As advocates of contractual freedom correctly note, fiduciary duty diminishes party autonomy and thus restricts the flexibility of partners. Persons entering into a partnership, especially with people they trust, might be unwilling to restrict their flexibility in the unlikely (in their mind) event that they find themselves at odds with one another. Moreover, the stronger partner (presumably, although not necessarily, the partner with the money) may anticipate activities that could be seen as taking advantage of his partner and may be reluctant to be ham-

45. *See* 2 ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP § 6.07 (1996).

strung. Finally, limited foreseeability gives the parties a somewhat short-term view, and this may obscure their ability or willingness to view the business in longer terms.

All of these reasons are, of course, somewhat speculative. But the reasons suggest that the parties themselves might not reach arrangements that necessarily are socially optimal. More sophisticated statements of this proposition recently have been made by Michael Klausner and William Bratton.[46] Professor Klausner has applied the economics of network externalities to the contractual paradigm of corporate law and has found that the results raise significant questions of the extent to which permitting radical contractual autonomy actually enhances social value. Arguing that the value of a corporate contract term may be related to the number of firms that use it, and that such interdependence may have particular value with respect to vaguer terms (one of which obviously is fiduciary obligation), he concludes that: "[W]hen network externalities are present . . . the outcome of decentralized individual maximizing decision in the market will be path dependent. Moreover, market forces may fail to produce socially optimal equilibria."[47] Thus, it is not at all clear that social interests are best served by a strong ethic of contractual freedom in the partnership setting.

Professor Bratton draws upon game theory to argue that "contracting can be inefficient," with the consequence that "the choice of legal institutions (in contrast to that of contractual terms) can be the primary influence on the efficiency of the outcome."[48] Bratton looks at game theory to find that, contrary to the assertions of contractarians, bargaining may be expected to result not in one best alternative, but in a variety of equilibria, thus obscuring the possibility that contracting always leads to the socially optimal result. In light of this observation, he offers a trust-based model of the firm that shares many characteristics with the observed legal/fiduciary model in which "self-interest and honor interplay" in a way that ensures both stability and efficiency.[49]

In light of all of these arguments, none of which appear to be addressed in the partnership literature, it is a far leap to conclude that diminished fiduciary duty and enhanced contractual freedom will result in efficient partnerships and that parties contractually will arrive at the desired level of fiduciary protection. Accepting as central the contract proponents' own

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46. *See* Bratton, *supra* note 32, at 142; Klausner, *supra* note 32, at 758-66.

47. Klausner, *supra* note 32, at 763-64. Moreover, although Klausner deals specifically with corporate law, he notes that his conclusions may apply to other long-term contractual and similar relationships, one of which obviously is the partnership. *Id.* at 766 n.25.

48. Bratton, *supra* note 32, at 153.

49. *Id.* at 167.

goals, their argument entirely fails. The result is that RUPA has been drafted on a wing and a prayer and wholly in the absence of both sophisticated argumentation and empirical justification.

b. The Social Importance of Fiduciary Duty: Social Norms and Ethics

By this point I think it is entirely clear that substantial arguments in favor of strong and mandatory fiduciary obligations cannot only be made, but can be made decisively without even joining issue on the ethical question of the values to be served by fiduciary obligation. It is enough to assume efficiency and hoist the contractarians on their own petard.

However, there is an ethical argument to be joined, for I think it worth arguing that fiduciary duty serves more than the value of efficiency. Fiduciary duty does, in a very real way, have — at least potentially — a meaningful impact on shaping the kind of society we choose to be or to become.

In one sense, I do not really need to leave the world of efficiency to make this argument, for to do so I draw upon the work of those proto-utilitarians, David Hume and Adam Smith.[50] Although there are differences in their moral theories, in the interests of space, I will discuss them together, because in the respects most relevant to my argument it is in their similarities that they are important.

Hume and Smith observed a world in which a person's conception of good behavior derived from the observed reaction of others not only to his own behavior, but to that of others as well. As Smith put it: "Every faculty in one man is the measure by which he judges of the like faculty in another."[51] From this, Smith and Hume posited the device of the impartial spectator, who serves as a hypothetical reference point from which to judge your own actions. Your actions would be governed by the supposed approval or disapproval of the spectator.

The relevance of this philosophical approach to the world of partnership law, and indeed to law in general, is the extent to which law has the capacity to effect behavior by setting out social norms. Certainly Cardozo realized the power of this fact and incidentally adopted an approach remarkably similar to Hume's and Smith's approach when he wrote in *Meinhard:*

> A managing coadventurer appropriating the benefit of such a lease without warning to his partner might fairly expect to be reproached with conduct that was underhand, or lacking, to say the least, in reasonable candor, if the partner were to surprise him in the act of signing the new

50. *See generally* DAVID HUME, A TREATISE OF HUMAN NATURE (L.A. Selby-Bigge ed., Oxford Univ. Press 2d ed. 1978) (1739); ADAM SMITH, THE THEORY OF MORAL SENTIMENTS (D.D. Raphael & A.L. MacFie eds., Liberty Fund 1984) (1759).

51. SMITH, *supra* note 50, at 19.

> instrument. Conduct subject to that reproach does not receive from equity a healing benediction.[52]

There is nothing arbitrary or vague in either the rhetoric used or the approach taken by Cardozo. It is nothing other than Hume's impartial spectator. The knowledge that one ought reasonably expect to be reproached if caught in *flagrante delicto* simply is a dramatization of our intuitive moral understanding that cheating on one's partner is wrong. No amount of carefully constructed efficiency arguments based on assumptions about human nature can obscure the power and truth of Cardozo's imagery. Most of us would be embarrassed if we were caught in the circumstances he described. That ought to tell us something.

Contemporary legal thinkers generally accept the proposition (as I do) that law and morality are not coterminous. But it is undeniable that we have laws that derive from moral precepts and that we use our laws to enforce moral precepts as well. The entire corpus of laws that have grown up around our constitutional equal protection and due process laws are grounded in the moral ideals of equality and justice. The laws may be efficient; they may not. But even if all of these laws could be demonstrated to be economically inefficient on the basis of some neoclassical model, I suspect that we would be hesitant to abandon these principles as *legal* precepts. Their very existence as legal mandates binding on the state (and through it, on a variety of forms of essentially private conduct) speaks volumes about the values our society holds and the ways we think about ourselves. Rules such as these are not inconsistent with our founding enlightenment vision of a nation of autonomous individuals cooperating to facilitate their respective goods. Nor are the rules inconsistent with a concept of market capitalism that envisions rough competition among actors to ensure the best use of resources and thus the greatest overall welfare. The rules are consistent, however, with a concept of persons as a society and with the notion that economic and political competitions are played out not in an environment of pre-Leviathan lawlessness, but on the basis of a set of ground rules.

In the laws of business organizations, fiduciary obligation traditionally has provided one of those ground rules. It may be that fiduciary doctrine is not crystal clear, in the sense of a rule requiring traffic to stop at red lights. But the argument from certainty can be overblown. Dean Weidner suggests that a principle motivation behind the "reformation" of fiduciary rules was the desire of lawyers to be certain that their negotiated agreements would be upheld.[53] For lawyers to argue that fiduciary duty creates signifi-

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52. Meinhard v. Salmon, 164 N.E. 545, 548 (N.Y. 1928).

53. Weidner & Larson, *supra* note 16, at 23.

cant uncertainty is specious. Anybody reading the cases soon develops a sense of what is and what is not allowed. Moreover, anyone in doubt can simply, like Cardozo, consult the impartial spectator. The literal enforcement of contracts, on the other hand, creates the possibility of manipulation, opportunism, and the exploitation of linguistic "loopholes," as business law shows time and again.[54]

We should move away from rhetoric and confront reality. The call to self-abnegation in fiduciary case law has never quite been the reality. No judge, not even Cardozo, appears to have expected partners to cast aside their worldly longings. What the language conveys is an attitude, a way of thinking about the relationship, which is not at all ambiguous for the language in which it is couched. It is the attitude of the impartial spectator, of the person who desires the approbation of his peers, as well as his own self-respect. It is an attitude that expresses the ideal that some kinds of competition and some forms of risk taking are quite appropriate in some circumstances and not in others. It is an attitude well expressed in *Labovitz v. Dolan*.[55] In *Labovitz*, one of the partners stated: "[T]he risk we took was that the business would not succeed. We did not take the risk that the business would succeed so well that the general partner would squeeze us out and take the investment for himself."[56]

It is, of course, within the power of the law to say that the risks of appropriation are in fact risks that are undertaken by partners with respect to one another. And there is a strong argument that RUPA's fiduciary provisions do exactly that. Certainly by attempting to specify particular aspects of fiduciary obligation and leaving the parties permission to specify others, RUPA has destroyed the attitude of cooperation and common purpose expressed by classic fiduciary doctrine and replaced it with a contract-like structure that invites haggling over language and opportunistic exploitation of loopholes. Perhaps this is what we want to achieve. But it is at least a fair question to ask whether a society that destroys the ethic of cooperation in its private organizations can long sustain the spirit of cooperation within itself.[57] It is a question that appears not to have been asked in the RUPA debate.

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54. Lawrence E. Mitchell, *The Fairness Rights of Corporate Bondholders*, 65 N.Y.U. L. REV. 1165, 1215-22 (1990); Lawrence E. Mitchell, *The Puzzling Paradox of Preferred Stock (And Why We Should Care About It)*, 51 BUS. LAW. 443, 476 (1996).

55. 545 N.E.2d 304, 313 (Ill. App. Ct. 1989).

56. Labovitz v. Dolan, 545 N.E.2d 304, 313 (Ill. App. Ct. 1989) (quoted in Weidner, *supra* note 12, at 91 n.47).

57. *See generally* Lon L. Fuller, *Two Principles of Human Association*, *in* NOMOS XI: VOLUNTARY ASSOCIATIONS 3 (J. Roland Pennock & John W. Chapman eds., 1969).