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Cadwalader, RUPA and Fiduciary Duty

Donald J. Weidner

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Cadwalader, RUPA and Fiduciary Duty

Donald J. Weidner*

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I. Introduction

In the summer of 1996, a state trial court applied the Uniform Partnership Act (UPA)¹ to a national law firm's closure of a branch office. In *Beasley v. Cadwalader, Wickersham & Taft*,² the court ordered an old-line Wall Street firm to pay more than \$3.5 million in damages and attorneys' fees, including \$500,000 in punitive damages, for violating its fiduciary duty by wrongfully expelling a partner in its Palm Beach office.³ The *Cadwalader* opinion is disappointing because it does not address the fundamental issue suggested by the facts, which is whether there was a rightful dissolution and reformation of an at-will law partnership.⁴ This article will explore that issue and the extent to which situations like *Cadwalader* are analyzed differently under the Revised Uniform Partnership Act (RUPA).⁵

II. The Cadwalader Scenario: Under the UPA

A. The Facts

Cadwalader, Wickersham & Taft (Cadwalader), which represents itself as the oldest law partnership in the United States, "having been founded in 1792,"⁶ is a national law firm with its primary office in New York City. In 1989, Cadwalader was trying to broaden the practice out of its Palm Beach office, which had been operating at a loss, by adding a litigation practice. Accordingly, plaintiff Jim Beasley became a partner in 1989 by "lateral transfer" from a Florida practice in which he had proven himself to be both an extraordinary rainmaker and a skilled litigator.

Although the Palm Beach office showed increased profits for the next two years, it also suffered from internal discord.⁷ In 1993, the office oper-

1. UNIF. PARTNERSHIP ACT (1914), 6 U.L.A. 238 (1995) [hereinafter UPA]. The original Uniform Partnership Act was adopted by the National Conference of Commissioners on Uniform State Laws in 1914.

2. No. CL-94-8646 "AJ," 1996 WL 438777 (Fla. Cir. Ct. July 23, 1996).

3. See Order on Plaintiff's Motion to Tax Costs and Attorneys' Fees, *Beasley v. Cadwalader, Wickersham & Taft*, No. CL-94-8646 "AJ," at 10-11 (Fla. Cir. Ct. Oct. 17, 1996).

4. For an analysis that is far more sympathetic with the court's approach, see Allan W. Vestal, "Assume a Rather Large Boat . . .": *The Mess We Have Made of Partnership Law*, 54 WASH. & LEE L. REV. 487 (1997).

5. REVISED UNIF. PARTNERSHIP ACT (1994), 6 U.L.A. 1 (1995) [hereinafter RUPA]. See generally ROBERT W. HILLMAN ET AL., GENERAL AND LIMITED LIABILITY PARTNERSHIPS UNDER THE REVISED UNIFORM PARTNERSHIP ACT (1996).

6. *Beasley v. Cadwalader, Wickersham & Taft*, No. CL-94-8646 "AJ," 1996 WL 438777, at *1 (Fla. Cir. Ct. July 23, 1996).

7. The court said the internal discord was "associated primarily with the personality

ated at a loss. At the same time, the value of the firm dropped by \$11,000 per share. In May of 1994, the Management Committee ordered computer analyses of the financial impact of partial and of complete closure of the Palm Beach office. A strategic planning committee was created to devise a long-term plan for expanding the Palm Beach office and improving morale. This committee never met because it was overtaken by events.

In 1994, the value of the firm decreased by an additional \$15,000 per share. Several of the younger, more productive partners made it clear that they would leave if the firm did not make changes quickly. In response to those demands, "Project Right Size" was born:

In short, "Project Right Size" was aimed at identifying less productive partners for elimination from the partnership. While it is clear that the Palm Beach office was of concern to the Management Committee before "Project Right Size" reared its head, . . . ultimately the closing of the Palm Beach office became integrated into "Project Right Size", with the common purpose being to improve compensation to the remaining partners and to retain the disgruntled more productive partners [N]umerous computer runs were generated for the management committee . . . analyzing the financial impact of terminating from ten to thirty partners.⁸

These financial analyses "were treated as confidential by the management committee and were not shared with most of the other partners."⁹ However, they were shared with at least one of "the young Turks."

Throughout this period, Beasley himself was dissatisfied. He met secretly with Cadwalader associates about leaving with him. One of the reasons for his dissatisfaction was that the firm's other relationships conflicted him out of cases he wanted to litigate. Judge Cook specifically found that he "suffered no loss of future income or benefits" because of his expulsion from the firm.

Judge Cook stated that the "watershed" of Project Right Size was a "clandestine" day-long management committee meeting held on August 7, 1994, at the Marriott Hotel in Manhattan. Prior to the meeting, management committee members were asked to submit lists of less productive partners to be considered for possible termination. The Marriott meeting identified

flaws of the other senior partner in the office." *Id.* The court continued: "[T]his partner, while being extraordinarily productive and skilled, was also extraordinarily disruptive, exhibiting unpredictable temper tantrums which the witnesses have described as 'rippling through the office' and creating severe morale problems." *Id.* In addition, Beasley's secretary complained of sexual harassment by two other partners. *Id.*

8. *Id.* at *2.

9. *Id.* at *2 n.2.

seventeen partners for expulsion, including all of the Florida partners. Later that month, the management committee voted to close the Florida office. At least some committee members neither read the partnership agreement to determine what, if anything, it said about expulsion nor consulted the firm experts on partnership law. On August 30, one day before it was announced at a general partnership meeting, the Palm Beach partners were told that their office would be closed effective the end of December.¹⁰ On October 3, the management committee circulated its plan to reduce the compensation of fourteen partners in other offices. On October 12, the firm membership, by a 67-12 vote, endorsed the management committee's action reducing the number of partners.¹¹

Mr. Beasley filed suit on November 9, 1994, and the next day the firm ousted him by letter from the firm offices. Judge Cook concluded that Cadwalader had wronged Mr. Beasley and, in a series of orders, directed the firm to pay him more than \$3.5 million in damages and attorneys' fees, including \$500,000 in punitive damages.

B. Judge Cook's Analysis

Cadwalader's partnership agreement did not discuss the expulsion of a partner. According to Judge Cook, the lack of an expulsion provision meant that "if Beasley was expelled, the partnership agreement was breached," whereas if Beasley voluntarily withdrew, "there was no breach."¹² Judge

10. The management committee said that it would consider a transfer of certain partners to New York, but agreed with Beasley that such a transfer would be impractical in his case. The court found that the firm did not make him a good faith offer to continue in its New York or Washington offices.

First, . . . Beasley and the other Florida partners had been designated for termination, not transfer Second, . . . Beasley's practice was in Florida, not in New York or Washington. He had been in South Florida for twenty-two years . . . and his client base was in Florida. His value . . . as a New York or Washington partner was greatly diminished, in that his rainmaking abilities would be severely impaired if not lost completely. Moreover, the firm was in the process of expelling partners in both New York and Washington because of low productivity. Obviously, it would be senseless to laterally transfer a partner without business to either of those offices.

Id. at *3.

11. *Id.* "The management committee action in terminating partners was not without opposition within the partnership, but ultimately it was endorsed by a sixty-seven to twelve vote of the partners in mid-October (the Moss resolution)." *Id.*

12. *Id.* The court rejected two arguments by the firm that Beasley had voluntarily withdrawn. The first was that Beasley voluntarily withdrew by failing to accept an offer of continuing partnership in either the New York City office or the Washington, D.C. office. The

Cook said: "While it is clear that the management committee had the power to close a branch office as part of its overall managerial authority, it is equally clear that the management committee did not have the right to expel a partner."¹³ Thus, he equated the management decision to close an office without relocating all partners with an expulsion and he said that the power to close an office does not include the right to expel.

Judge Cook appears to have been saying much more than that the expulsion was wrong because it was unauthorized. He appears to conclude that the expulsion was wrong because it was improperly motivated and that the improper motivation supports an award of punitive damages.¹⁴ He rejected the argument that a management committee breaches no fiduciary duty when it closes a branch office for financial reasons. Indeed, the consideration of the best financial interest of the majority of the partners was what Judge Cook apparently found inappropriate. To the statement of the Co-chair of the management committee that "life is not made up of love, it is made up of fear and greed and money — how much do you get paid in large measure," Judge Cook responded: "While life in the market place may well be made up of fear, greed and money, life in a partnership is not so composed."¹⁵ He said that "the ouster of Beasley and the other partners was done for the express purpose of producing greater profits for the remaining partners."¹⁶ There was a "clandestine plan to wrongfully expel some part-

court said that the offer to transfer to Washington or New York "was not a good faith offer of continued partnership." *Id.* In addition, the court said that, even if it had been a good faith offer, Beasley's rejection of it "was appropriate and did not constitute a voluntary withdrawal from the firm." *Id.* at *4. Second, the court rejected the argument that Beasley had voluntarily withdrawn by filing suit. The court said that "so long as the suit for dissolution is not frivolous, it cannot constitute a voluntary withdrawal from the partnership." *Id.* It also said that New York partnership law contemplates suits among partners. *Id.*; cf. RUPA § 405.

13. *Cadwalader*, 1996 WL 438777, at *4.

14. Professor Vestal reaches the same conclusion about the breadth of Judge Cook's holding. "Judge Cook found the breach of fiduciary duty, apparently based on [the claim] that the motivation for the expulsion was the financial gain of the remaining partners." Vestal, *supra* note 4, at 491. He emphasizes that "Beasley based his punitive damages claim on Cadwalader's breach of fiduciary duty." *Id.* at 493. After reviewing what he considers the "almost adolescent bravado" of the insurgent partners, whom he characterizes as "witless thugs," Professor Vestal declares Judge Cook's leap to be "analysis" that has his approval: "Judge Cook's core analysis in *Cadwalader* is solid." *Id.* at 495-97.

15. *Cadwalader*, 1996 WL 438777, at *7.

16. *Cadwalader*, 1996 WL 438777, at *6. The court relied on this factor to distinguish *Cadwalader* from another fiduciary duty case involving partnerships. See *Day v. Sidley & Austin*, 394 F. Supp. 986, 993-94 (D.D.C. 1975), *aff'd sub nom.* *Day v. Avery*, 548 F.2d 1018 (D.C. Cir. 1976). The court in *Day* stated: "No court has recognized a fiduciary duty to disclose [information regarding changes in the internal structure of the firm], the conceal-

ners for the financial gain of other partners."¹⁷ He noted that the management committee consulted neither the partnership agreement nor the firm's partnership experts to probe the rights of the Palm Beach partners. "If Beasley had dirt under his fingernails, [Cadwalader] was up to its' [sic] elbows in the dung heap."¹⁸ It was "a gross breach of fiduciary duty for some partners to throw others overboard for the expediency of increased profits."¹⁹

C. Expulsion Pursuant to Agreement

The UPA provides that dissolution is caused "[b]y the expulsion of any partner from the business bona fide in accordance with such a power conferred by the agreement between the partners."²⁰ There is authority for the proposition that the expulsion agreement²¹ may be oral rather than written.²²

ment of which does not produce any profit for the offending partners nor any financial loss for the partnership as a whole" *Id.* at 993; *see infra* text accompanying notes 53-64.

17. *Cadwalader*, 1996 WL 438777, at *6. Beasley himself had been planning to leave the firm and had secretly spoken with three Cadwalader associates about leaving with him. The court said that, even if his secret conversations breached his fiduciary duty, it would be insufficient to defeat his claim. "It would not be equitable to allow Beasley's actions in this regard to stand as a defense to Cadwalader's much more egregious conduct." *Id.*

18. *Id.*

19. *Id.* at *7. The court listed the following facts relevant to its punitive damage determination:

1. The partnership agreement contains no clause authorizing the expulsion of a partner from the firm.
2. In addition to the clear language of the partnership agreement, the management committee had Mr. Robertson's legal memorandum which told them that they did not have the authority to expel partners.
3. Management committee members testified that they had not even read the partnership agreement to determine what it said about expelling partners prior to determining to take such action.
4. [Cadwalader] is a partnership of highly skilled attorneys and includes experts on partnership law. These experts were not consulted before partners were expelled.
5. The expulsion was for the express purpose of increasing the compensation available to the other partners.

Id.

20. UPA § 31(1)(d).

21. Under the UPA, special rules apply to a dissolution caused by expulsion pursuant to the partnership agreement. *See* UPA § 38(1). The UPA states: "[I]f dissolution is caused by expulsion of a partner, bona fide under the partnership agreement and if the expelled partner is discharged from all partnership liabilities, either by payment or agreement under section 36(2), he shall receive in cash only the net amount due him from the partnership." *Id.* For a discussion of RUPA's expulsion rules, *see* HILLMAN ET AL., *supra* note 5, at 198-204.

22. *See* Frank v. R.A. Pickens & Son Co., 572 S.W.2d 133, 135 (Ark. 1973) (relying on oral agreement that one partner "had exclusive control over the terms of admission and expulsion of the partners"). In another case, the court admitted parole evidence offered by

There is also authority stating that the partnership need not provide any particular process to the partner it is expelling — it is permissible to have a "guillotine" expulsion with no notice or hearing.²³

The precise contours of the "bona fide" limitation are unclear. One court has said that "good faith" has a very limited meaning in the expulsion context:

Where the . . . partners . . . deem it necessary to expel a partner under a no cause expulsion clause in a partnership agreement freely negotiated and entered into, the expelling partners act in "good faith" regardless of motivation if that act does not cause a wrongful withholding of money or property legally due the expelled partner at the time he is expelled.²⁴

Under this analysis, a court will not require the expelling partners to justify an expulsion.²⁵ Although an expulsion is not actionable simply because it is motivated by self-interest,²⁶ it is in bad faith if it causes a forfeiture or other

an expelled partner because the written partnership agreement contained "no true integration clause." *Lawlis v. Kightlinger & Gray*, 562 N.E.2d 435, 439 n.1 (Ind. Ct. App. 1990); cf. *Heller v. Pillsbury Madison & Sutro*, 58 Cal. Rptr. 2d 336, 345 (Cal. Ct. App. 1996) (stating that "the parties intent that a written agreement be integrated 'may be manifested even in the absence of an explicit statement to that effect'" (citation omitted)). The court must consider the intent of the parties, which includes a consideration of "the circumstances surrounding the partnership agreement." *Id.*

23. In *Holman v. Coie*, the court allowed a summary "guillotine approach," rather than "a more diplomatic approach," to the expulsion of law partners. *Holman v. Coie*, 522 P.2d 515, 524 (Wash. Ct. App. 1974). The court refused to infer or imply requirements of notice, reasons or an opportunity to be heard, noting that "additional requirements should not be added to unambiguous expulsion provisions." *Id.* at 522. The *Lawlis* court also discussed the guillotine method, noting:

At the time the partners negotiated their contract, it is apparent they believed . . . the "guillotine method" of involuntary severance, that is, no notice or hearing, only a severance vote to terminate a partner involuntarily need be taken, would be in the best interests of the partnership. Their intent was to provide a simple, practical, and above all, a speedy method of separating a partner from the firm, if that ever became necessary for any reason. We find no fault with that approach to severance.

Lawlis, 562 N.E.2d at 442. See generally ROBERT W. HILLMAN, HILLMAN ON LAWYER MOBILITY: THE LAW AND ETHICS OF PARTNER WITHDRAWALS AND LAW FIRM BREAKUPS § 5.3 (1996) (hereinafter *LAWYER MOBILITY*).

24. *Lawlis*, 562 N.E.2d at 442-43.

25. See *id.* at 443. The court explained that to hold otherwise "would be engrafting a 'for cause' requirement upon [the] agreement when such was not the intent of the parties at the time they entered into their agreement. Mere lapse of time . . . does not alter that initial intent." *Id.*

26. See *Gill v. Mallory*, 80 N.Y.S.2d 155, 157 (N.Y. App. Div. 1948).

The plaintiffs' contention is that the majority decision was made selfishly and therefore not in good faith. We do not think that it was the purpose of the agreement to

breach of public policy.²⁷ Courts will monitor whether reliance on clauses that permit expulsion without justification is cloaking opportunistic behavior.²⁸

It appears that the only argument in *Cadwalader* that there was an agreement permitting expulsion was that the management committee had both the power and the right to expel. In particular, Cadwalader argued that the management committee's power to set compensation is tantamount to an expulsion provision because compensation could be set at zero or at other levels that would force departures. Judge Cook rejected this argument because "[t]here is no express reference to expulsion and a reasonable person reading this provision would not draw the conclusion that the management committee had been granted the power to expel a partner from the firm."²⁹

Because Judge Cook found that the agreement did not authorize expulsions, he understandably concluded that the partnership had not rightfully expelled Mr. Beasley pursuant to agreement. His analysis should have gone further, however, to consider whether the conduct that failed to qualify as a rightful expulsion pursuant to agreement nevertheless qualified as a rightful dissolution by express will.

offer such an issue to be litigated whenever this clause in the agreement was availed of by a majority in interest. The purpose was to minimize litigation, not to create new issues to be tried in addition to those which would ordinarily be attendant upon dissolution.

Id.; see *Holman*, 522 P.2d at 522 (quoting same language with approval); see also HILLMAN, *supra* note 23, § 5.3.3.

27. *Gelder Med. Group v. Webber*, 363 N.E.2d 573, 576 (N.Y. 1977).

28. In *Winston & Strawn v. Nosal*, the court endorsed the principle that "partners owe one another a duty of good faith in the context of expulsion, even where the partnership agreement permits expulsion without cause." *Winston & Strawn v. Nosal*, 664 N.E.2d 239, 245 (Ill. App. Ct. 1996). The court concluded that a triable issue had been presented because the facts alleged

raise an inference that [the partner] was expelled solely because he persisted in invoking rights belonging to him under the partnership agreement and that the reasons advanced by the firm were pretextual. Regardless of the discretion conferred upon partners under a partnership agreement, this does not abrogate their high duty to exercise good faith and fair dealing in the execution of such discretion.

Id. at 246; see also *Heller v. Pillsbury Madison & Sutro*, 58 Cal. Rptr. 2d 336 (Cal. Ct. App. 1996); *Bohatch v. Butler & Binion*, 905 S.W.2d 597 (Tex. App. 1995, writ granted).

29. *Beasley v. Cadwalader, Wickersham & Taft*, No. CL-94-8646 "AJ," 1996 WL 449247, at *1 (Fla. Cir. Ct. Mar. 29, 1996). But see *Simpson v. Ernst & Young*, 100 F.3d 436, 441, 444 (6th Cir. 1996) (holding that partner who was "subject to the virtually absolute, unilateral control of the Management Committee" was an employee for purposes of both the Age Discrimination in Employment Act and the Employee Retirement Income Security Act).

D. The Right to Dissolve and Reform

Under the UPA, expulsion by agreement is simply one way to dissolve a partnership. Even if the closing of the West Palm Beach office was not an effective expulsion, it was an effective dissolution by express will if any partner's association with the firm was ending.³⁰ Because of the express will of at least one partner, the partners experienced a "change in the relation" such that they "ceased to be associated in the carrying on . . . of the business."³¹ The partnership relationship that had included all the Palm Beach partners contracted in scope and continued for the limited purpose of winding up. At the same time, a new partnership was formed without the Palm Beach partners who were not relocated to other offices.³²

The question is whether the dissolution by express will was rightful or wrongful.³³ The rule has always been that, in a partnership at will, each partner has not merely the *power*, but also the *right* to dissolve at any time.³⁴ This is true even if the partnership agreement provides that a dissolution will not cause a liquidation of the business. Unless there was an agreement to

30. Some authority suggests that partners may contract away not only the right to dissolve, but also the power to dissolve. See *Cohen v. Lord, Day & Lord*, 550 N.E.2d 410, 413 (N.Y. 1989) ("[U]nless there is an agreement to the contrary, withdrawal of a partner constitutes dissolution of the law partnership." (citation omitted)). Some states have modified the UPA to permit partners to contract away dissolution. See ARK. CODE ANN. §§ 4-42-601, 4-42-603 (Michie 1996); CAL. CORP. CODE § 15031 (West 1991); see also *Heller*, 58 Cal. Rptr. 2d at 347 n.6. However, the proper interpretation of the UPA, when not specially amended, is that a "dissolution" takes place whenever a partner ceases to be associated in the carrying on of the business, even if the partners have agreed not to liquidate the business. UPA § 31. A major problem with the concept of dissolution under the UPA is confusion between the causes of dissolution and its consequences. When a partner leaves a firm, a number of things must happen. The partner's liability for the actions of other partners must be contracted and extinguished. The agency power of the other partners to bind the partner must be contracted and extinguished. The partner's liability for unfinished business must be contracted and extinguished. The partner must be paid the partner's equity in the partnership. The UPA provisions making these things happen are activated by, and only by, a dissolution. See HILLMAN, *supra* note 23, § 4.3 (describing dissolution as "term of art under the UPA").

31. UPA § 29.

32. See HILLMAN, *supra* note 23, § 5.3.2. "The 'firing' of a partner unsupported by an underlying expulsion agreement is not an expulsion but is a dissolution by express will of the partners initiating the 'removal' of one of their colleagues." *Id.*

33. In statutory terms, the question is whether there was a dissolution by "express will" under UPA § 31(1)(b) (without violation of the partnership agreement because "no definite term or particular undertaking is specified"), or a dissolution by "express will" under UPA § 31(2) (in "contravention" of the partnership agreement and not otherwise authorized by statute). See UPA § 31.

34. UPA §§ 31(1)(b), 38(1); RUPA § 801(1).

remain partners for a specific term or undertaking, each Cadwalader partner had the right to dissolve at any time. Accordingly, any group of partners had the right to dissolve and to form a new partnership without the others.

The dissolution/reformation analysis applies even if the partnership is a very large one and even if all but one of the members takes part in the reformation. One should contrast Judge Cook's interpretation of New York law with the interpretation of the same law by the New York Court of Appeals. In *Dawson v. White & Case*,³⁵ the New York Court of Appeals addressed a large law firm's dissolution and reformation without a person who had been a partner for almost twenty years, stating:

"[A]t the heart of the partnership concept" is "the principle that partners may choose with whom they wish to be associated." In recognition of this principle, we have held that a partnership agreement may contain a termination provision or some other mechanism by which to remove a partner. Absent such a mechanism, however, the removal of a partner can be accomplished only through dissolution of the firm, defined as a "change in the relation of the partners caused by any partner ceasing to be associated in the carrying on . . . of the business." The White & Case partnership agreement did not contain an express termination provision, and so, in order to remove Dawson, the partners voted to dissolve the firm and then to immediately re-form without him.³⁶

The court stated that, while partners are "statutorily empowered to dissolve the partnership at any time, wrongfully dissolving partners may be liable to the expelled partner for breach of the partnership agreement when the partnership is not at will."³⁷

E. At-Will Partnerships and Specific Understandings

Cadwalader appears to have been an at-will partnership, under the normal use of the term. The term "at-will" is normally defined in the negative to refer to partners who have not agreed to remain together either for a fixed term or until a particular undertaking is completed.³⁸ The term either can be expressed or inferred from the circumstances.

35. 672 N.E.2d 589 (N.Y. 1996).

36. *Dawson v. White & Case*, 672 N.E.2d 589, 591-92 (N.Y. 1996) (citations omitted). Cadwalader may have avoided the dissolution/reformation argument because the partnership agreement said the firm's New York office building must be sold in the event of dissolution.

37. *Id.* at 591 n.1 (citations omitted).

38. Although the UPA contains no formal definition of partnership at will, UPA section 31(1)(c) refers to a "specified term or particular undertaking." UPA § 31(1)(c); cf. RUPA § 101(6) (stating "[p]artnership at will" means a partnership in which the partners have not agreed to remain partners until the expiration of a definite term or the completion of a particular undertaking").

Even if Cadwalader was not a term partnership, the partners arguably made a special and important commitment to make their relationship work. Mr. Beasley's complaint alleged that the partnership agreement provided:

The parties to this Agreement mutually pledge to each other their best efforts to aid each other's professional success and advancement during the continuance of this partnership, so that each party shall receive from the others a fair opportunity to use his best talents and faculties to the common benefit, and shall have an approximate if not complete or perfect compensation for his industry and abilities out of the partnership funds.³⁹

This language arguably supports a heightened degree of fiduciary or other obligation within the firm. The court in *Cadwalader* might have resolved the case by exploring the intent of this language and its application over the years. Does the language mean that profit motive must be discounted in light of other values?⁴⁰ Does it mean that the partners pledge extraordinary efforts to remain associated for as long as possible? Does it mean that partners are to take extraordinary efforts to overcome internal strife? Does it mean that guillotine expulsions are inappropriate? Does it mean that continuing partners pledge extraordinary efforts to relocate partners excluded from reformation? On the other hand, does the last portion of the quoted language mean that the partners reject lock-step compensation and embrace competition among themselves? The most disappointing aspect of Judge Cook's opinion is that it does not examine the partnership agreement or the partners' reasonable expectations of their relationship.

F. Post-Dissolution Rights and Duties

Apart from the argument that the Cadwalader partnership agreement required an extraordinarily high level of loyalty or other obligation among the partners, the strongest argument in Mr. Beasley's favor is that the firm violated his post-dissolution rights. When a partnership is dissolved, dominant partners may use their superior knowledge of the firm and their superior

39. Amended Complaint for Dissolution of Partnership, Appointment of a Receiver, Accounting, and Other Relief, and Demand for Jury Trial at Exhibit A, pp. 41-42, *Beasley v. Cadwalader, Wickersham & Taft*, No. CL-94-8646 "AJ," 1996 WL 438777 (Fla. Cir. Ct. July 23, 1996).

40. *Cf. Starr v. Fordham*, 648 N.E.2d 1261, 1264 (Mass. 1995) (involving partnership that induced lawyer to join partnership claiming his inability to generate business would not affect his share of firm profits). The court found that this was a tortious misrepresentation by a founding partner, who had "intended client origination to be the dominant factor for allocating profit shares when he made his representation to the contrary to the plaintiff." *Id.* at 1267.

position to wrest control over assets, prevent a liquidation of the partnership business, grab a larger share of the business or its proceeds, or control the winding up. These are the basic wrongs that are suggested in situations like *Cadwalader*.

In a very public way, dominant partners in *Cadwalader* were contemptuous of the suggestion that the partnership had dissolved and must face the consequences.⁴¹ It is possible that they wanted to continue claiming that *Cadwalader* is the oldest law partnership in the United States, and not simply a transitory relationship in a long series of dissolutions and reformations. It is possible that they believed they had contracted away dissolution and its consequences. It is also possible that they could not grasp that the rules that apply to small firms also apply to large firms.⁴² Perhaps they were trying to play hard ball with the Palm Beach partners. Perhaps they were overly confident or insufficiently astute.⁴³ Whatever the reasons, their actions appear to have denied Mr. Beasley his dissolution rights.

The *Cadwalader* partnership agreement provided that dissolution would not be caused by the withdrawal or death of any partner, or by any other event, unless 75% of the remaining partners agreed in writing. Because "such agreements are in derogation of the common law and the Uniform Partnership Act," said Judge Cook, they "should be strictly construed and applied."⁴⁴ Specifically, a partner who seeks to rely on an anti-dissolution

41. See Amy Stevens, *Prestigious Law Firm Gets Sued By a Partner It Would Not Keep*, WALL ST. J., Nov. 11, 1994, at B1. Stevens reported:

Mr. Beasley is asking the . . . court to liquidate the firm's assets, of which he wants his share. . . . John Fritts, co-chair of *Cadwalader's* management committee, describes the lawsuit as "frivolous." As to the claim that the partnership has been dissolved, he says: "That's a bit of foolishness. The partnership is technically dissolved every time a partner leaves, and nothing happens. It's a paper, legalistic transaction and has none of the consequences he alludes to."

Id.

42. It is hardly irrational to assume that large partnerships might be subject to different rules. Cf. *Simpson v. Ernst & Young*, 100 F.3d 436, 441, 444 (6th Cir. 1996) (holding that "partner" was "employee" for purposes of both Age Discrimination in Employment Act and Employee Retirement Income Security Act). The court stated: "The characterization of 'partner' was a title that carried no legal significance [and] which could be disclaimed when convenient to the defendant's management. Simpson and his similarly situated colleagues were relegated to the position of an employee subject to the virtually absolute, unilateral control of the Management Committee." *Id.* at 441.

43. Professor Vestal provides a harsh assessment of the behavior of certain *Cadwalader* partners. See Vestal, *supra* note 4, at 495-96 (discussing "almost adolescent bravado of the insurgents" and characterizing "insurgents and managing partners" as "witless thugs").

44. *Beasley v. Cadwalader, Wickersham & Taft*, No. CL-94-8646 "AJ," 1996 WL 449247, at *2 (Fla. Cir. Ct. March 29, 1996).

provision "must operate within the bounds of the agreement."⁴⁵ An unauthorized expulsion is a breach of the agreement, which prevents the expelling partners from relying on the anti-dissolution provision. It also prevents them from relying on provisions limiting the amount to be paid to a withdrawing partner. Judge Cook made all these points in an Order Denying Motions for Summary Judgment. Although his Final Judgment concluded that there had been an unauthorized expulsion that breached the partnership agreement, it contained no discussion of Mr. Beasley's rights as a member of a dissolved partnership.

If a partnership is at will, absent agreement to the contrary, a partner in dissolution has four basic dissolution rights. First, a partner has the right to liquidate the partnership business and apply the proceeds to satisfy liabilities.⁴⁶ The partner has the right to insist that the partnership account for all partnership property in this process, including partnership opportunities. Second, each partner has the right to receive payment in cash for the partner's share of any surplus.⁴⁷ The partner cannot be forced to accept an in-kind distribution. Third, each partner has the right to participate in the process of winding up.⁴⁸ Indeed, if a dissolution is wrongful, an innocent partner has the right to exclude wrongful dissolvers from the conduct of the winding up.⁴⁹ Fourth, each partner has the right to expect bargaining in good faith.

1. Accounting for Assets and Other Expectations

The UPA provides that a partner "must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property."⁵⁰ On dissolution, a central task is to identify the assets, benefits, and profits for which the partnership must account. Some assets are easier to identify and value than others. In law firms, a partner's interest in unfinished business is often an issue. Just as a partner is liable for the completion

45. *Id.*

46. See UPA § 38(1) (stating "[w]hen dissolution is caused in any way, except in contravention of the partnership agreement, each partner, . . . unless otherwise agreed, may have the partnership property applied to discharge its liabilities, and the surplus applied to pay in cash the net amount owing to the respective partners").

47. See *id.*; see also RUPA § 807(a) (continuing "in cash" rule).

48. See UPA § 37.

49. See *id.*

50. UPA § 21(1).

of unfinished business, the partner also has a right to share in the profits from that business.

The stereotypical law firm case involves a personal injury law firm that represents plaintiffs on a contingent fee basis. Shortly before a lengthy and major case settles or goes to trial, the firm breaks up and the lawyers handling the case leave and take the client with them. The question is who has the right to share in the division of the contingent fee and in what proportion. The lawyers handling the case are not permitted to deny their partners the right to share in the fee.⁵¹

On the other hand, the law is far less clear with respect to many partnership breakups. It is not always possible to attribute future income to the completion of specific matters pending at the time of dissolution. In some practices, it is easy to characterize future income, even from the same client, as attributable to new matters.⁵² It may be difficult if not impossible to prove a reasonable expectation of sharing in these matters.

In *Day v. Sidley & Austin*,⁵³ a partner asserted an expectation with respect to control itself.⁵⁴ In *Sidley & Austin*, the former chairman of Sidley & Austin's Washington, D.C. office claimed that a merger stripped him of his office, caused him a loss of income, and humiliated him, all in breach of the partnership's fiduciary duties. Mr. Day claimed that the firm forced him to resign, in part because of meetings that were held without him. The court concluded that there was no remedy for his "diminution in status" because "he had no vested contractual right to remain the sole chairman."⁵⁵ Indeed, there was no legal remedy for him even if the firm had made a misrepresentation to him about his status after the merger because he "was

51. See *Beckman v. Farmer*, 579 A.2d 618, 636 (D.C. 1990) ("[P]ending cases are uncompleted transactions requiring winding up after dissolution, and are therefore assets of the partnership subject to post-dissolution distribution."); *Schrempp & Salerno v. Gross*, 529 N.W.2d 764, 772 (Neb. 1995) (concluding that fees on cases "are part of the winding up of firm assets").

52. See HILLMAN, *supra* note 23, § 4.6.4.

Clients who offer discrete projects requiring substantial legal services over an extended period of time are less "valuable" to control than clients with business that departing partners might more easily label "new" at any point. Not only are the former less likely to offer repeat business for their lawyers, but also the need to share fees paid upon the completion of their projects lessens or eliminates the benefits of grabbing this type of client.

Id.

53. 394 F. Supp. 986 (D.D.C. 1975).

54. *Day v. Sidley & Austin*, 394 F. Supp. 986, 991 (D.D.C. 1975), *aff'd sub nom. Day v. Avery*, 548 F.2d 1018 (D.C. Cir. 1976).

55. *Id.* at 991.

not deprived of any *legal* right as a result of his reliance on [the] statement."⁵⁶

The court emphasized Mr. Day's reasonable expectations under the partnership agreement, stating that he "could not have reasonably believed that the status of the Washington Office Committee was inviolate and beyond the scope and operation of the Partnership Agreements."⁵⁷ The partnership agreements gave the Executive Committee great authority. Mr. Day "had no contractual right" to maintain his authority over the Washington Office: "Since he did not have a legal right to maintain his status in the firm, the conspiracy charge amounts to no more than an internal power sweep, executed and permitted under the provisions of the partnership agreement, for which there is no legal remedy."⁵⁸ Similarly, there was no wrongful dissolution or wrongful ouster because the partnership agreement entrusted an executive committee with all questions of firm policy, and authorized the admission and severance of partners by majority vote.⁵⁹

The court in *Sidley & Austin* distinguished the structural change caused by the merger from the kind of appropriation of an opportunity that violates a fiduciary duty. Even though there were secret merger negotiations, "the courts have been primarily concerned with partners who make secret profits at the expense of the partnership,"⁶⁰ such as by surreptitiously purchasing a building that the partnership might have acquired. Mr. Day's claim was different:

What plaintiff is alleging in the instant case, however, concerns failure to reveal information regarding changes in the internal structure of the firm. No court has recognized a fiduciary duty to disclose this type of information, the concealment of which does not produce any profit for the offending partners nor any financial loss for the partnership as a whole.⁶¹

The court did not deny that the merger may have been "profit" motivated. Despite profit motivation, the merger and consolidation of control was not an actionable appropriation of an opportunity.

56. *Id.*

57. *Id.* at 992.

58. *Id.*

59. *Id.*; see *Betz v. Chena Hot Springs Group*, 657 P.2d 831, 834-35 (Alaska 1982) (discussing judicial deference to management decisions in context of "involuntary retirement" provisions in partnership agreement). In *Betz*, the involuntarily retired partner received compensation based on an elaborate valuation formula. See *id.* at 835-36; see also *Exxon Corp. v. Burglin*, 4 F.3d 1294 (5th Cir. 1993).

60. *Sidley & Austin*, 394 F. Supp. at 993.

61. *Id.* at 993-94.

Cadwalader argued that, under *Sidley & Austin*, Mr. Beasley was rightfully bound by the management committee's decision to close the Palm Beach office.⁶² Cadwalader argued that, like Mr. Day, Mr. Beasley had no "vested right" in a partnership at will. Judge Cook was not very persuasive when he distinguished *Sidley & Austin*, stating only that "the ouster of Beasley and the other partners was done for the express purpose of producing greater profits for the remaining partners."⁶³

Despite Judge Cook's attempt to distinguish *Sidley & Austin*, the two cases are remarkably similar. The difference is in the opinions. The *Sidley & Austin* opinion paid particular attention to Mr. Day's status as a partner at will and to his reasonable expectations under the partnership agreement. Judge Cook did not. Unlike Judge Cook, the court in *Sidley & Austin* distinguished a structural change from an actionable appropriation. *Cadwalader* appears to equate an attempt to dissociate from a problematic partner with an attempt to appropriate a contingent fee.⁶⁴ Unlike the *Sidley & Austin* decision, *Cadwalader* shifts the focus from where it belongs, which is on the reasonable expectations under the partnership agreement, to the motivation behind the decision to dissolve. The court suggests that the very decision to dissolve is actionable if profit is a motivator. In so doing, *Cadwalader* represents a problematic addition to the line of cases recognizing a cause of action for bad faith dissolution of an at-will partnership.

2. Bad Faith Dissolutions of At-Will Partnerships

The major qualification⁶⁵ to the rule that a partner may rightfully dissolve an at-will partnership is a line of cases, based on *Page v.*

62. See *Frank v. R.A. Pickens & Son Co.*, 572 S.W.2d 133, 135 (Ark. 1973); cf. *Heller v. Pillsbury Madison & Sutro*, 58 Cal. Rptr. 2d 336, 346 (Cal. Ct. App. 1996) (concluding that Executive Committee had power to expel without cause).

63. *Beasley v. Cadwalader, Wickersham & Taft*, No. CL-94-8646 "AJ," 1996 WL 438777, at *6 (Fla. Cir. Ct. July 23, 1996).

64. Mr. Beasley analyzes the situation differently. See *Stevens*, *supra* note 41, at B1. Mr. Beasley says he was fired because his office was "too successful." His lawsuit claims Cadwalader is "attempting to appropriate millions of dollars in Florida-generated revenue in an effort to help solve the firm's financial problems." The 51-year-old litigator says he collected an average of \$2.3 million a year since 1989, when he was recruited from another firm.

Id. (citations omitted).

65. See *Leff v. Gunter*, 658 P.2d 740, 746 (Cal. 1983). The California Supreme Court in *Leff* made clear that a partner cannot "immunize" himself from his fiduciary duties owed to at-will partners by leaving the partnership. *Id.* Moreover, a partner does not leave simply by saying "I quit." The partnership relation continues until all partnership affairs are wound up. RUPA section 802(a) provides that "a partnership continues after dissolution . . . for the purpose of winding up its business." RUPA § 802(a).

Page,⁶⁶ stating that a partner may not dissolve an at-will partnership in bad faith.⁶⁷ *Page* states that a partner's right to dissolve is qualified by the obligation to refrain from a "bad faith" appropriation of "new prosperity without adequate compensation."⁶⁸

Page involved an at-will linen supply partnership that was beginning to profit after losing money for years. The partnership was heavily indebted to a corporation owned by a partner we can call Rich. Rich wanted to terminate the partnership but his partner Poor resisted, pointing to a nearby, newly-established Air Force base as a source of imminent profit. Rich sought a declaratory judgment, which the California Supreme Court granted, stating:

A partner at will is not bound to remain in a partnership, regardless of whether the business is profitable or unprofitable. A partner may not, however, by use of adverse pressure "freeze out" a co-partner and appropriate the business to his own use. *A partner may not dissolve a partnership to gain the benefits of the business for himself, unless he fully compensates his co-partner for his share of the prospective business opportunity* If [the dissolving partner] acted in bad faith and violated his fiduciary duties by attempting to appropriate to his own use the new prosperity of the partnership without adequate compensation to his co-partner, the dissolution would be wrongful⁶⁹

The decision in *Page* received both praise and criticism.⁷⁰ The critics asserted that *Page* created new and uncertain doctrine that invites too much

66. 359 P.2d 41 (Cal. 1961).

67. See *Page v. Page*, 359 P.2d 41, 44 (Cal. 1961). The termination of a branch office by the home office of a law firm is analogous to the termination of a franchisee by a franchisor. A minority of franchise termination cases hold that the franchisor-franchisee relationship can be a fiduciary one that constrains the franchisor from arbitrary termination. See *Arnott v. American Oil Co.*, 609 F.2d 873, 882 (8th Cir. 1979). "A franchisee, unlike a tenant pursuing his own interests, builds the goodwill of his own business and the goodwill of the franchisor. This facet of the relationship has led to the recognition that the franchise relationship imposes a duty upon franchisors not to act arbitrarily in terminating the franchise." *Id.* (citations omitted).

68. See *Page*, 359 P.2d at 44.

69. *Page*, 359 P.2d at 44-45 (emphasis added). A wrongful dissolver has no right to control the process of winding up. Compare UPA § 37, with RUPA §§ 602, 803. RUPA section 602(b) places statutory limits on the definition of wrongful dissociation. RUPA § 602(b).

70. Compare Anthony L. Marks, Comment, *Barefoot Shoemakers: An Uncompromising Approach to Policing the Morals of the Marketplace When Law Firms Split Up*, 19 ARIZ. ST. L.J. 509, 511-12 (1987), with Robert W. Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanency of Partnerships and Close Corporations*, 67 MINN. L. REV. 1, 29 (1982).

litigation against dissociated partners who successfully continue in the same line of business.⁷¹

The court in *Rosenfeld, Meyer & Susman v. Cohen*⁷² applied *Page* to the stereotypical contingent fee case.⁷³ The court could have resolved the case simply by stating that the departing litigators were required to share the fee from the unfinished business they took with them. It went further, however, echoing the *Page* suggestion that a partner may not dissolve an at-will partnership in bad faith: "[T]he . . . ruling that as a matter of law a partner has the absolute right to dissolve a partnership at will without regard to breach of fiduciary consequences is contrary to the principle that a person may be estopped from exercising rights in bad faith."⁷⁴ On the other hand, the court in *Rosenfeld, Meyer & Susman* suggests a more narrow definition of a bad faith dissolution. The court retreated from the *Page* statement of a duty to compensate for a "prospective business opportunity." Instead, the court said that a departing partner "may take for his own account new business even when emanating from clients of the dissolved partnership . . ."⁷⁵

If *Cadwalader* means that a dissolution is wrongful if financially motivated, and not merely that an unauthorized expulsion is a breach of fiduciary duty, then it goes beyond cases like *Page* and *Rosenfeld, Meyer & Susman*. It goes further because it has no focus on the appropriation of a particular business opportunity.⁷⁶ *Page* focused, at a high level of generality that may be explained by advance declaratory relief, on the opportunity created by the new Air Force base. *Rosenfeld, Meyer & Susman* focused on the appropriation of a contingent fee. The "bad faith" language in these cases may stand for nothing more than the general proposition that courts will defend their authority to monitor for appropriated opportunities. Perhaps all the courts are saying is that they will not relinquish jurisdiction to monitor at-will relationships. *Cadwalader* appears to go beyond these cases because it does

71. See Hillman, *supra* note 70, at 29. Hillman states that whether a new prosperity has been appropriated cannot be determined at the time of dissolution. The "result contemplated is harsh and conducive to litigation requiring the retroactive analyses of motives behind dissolutions." *Id.* at 31. Hillman continues, "After *Page*, any partner dissolving such a partnership runs the risk that if he or she continues in the same line of business the dissolution will later be found to have involved a wrongful appropriation of the new prosperity of the business." *Id.* But see Marks, *supra* note 70, at 511-12.

72. 194 Cal. Rptr. 180 (Cal. Ct. App. 1983).

73. *Rosenfeld, Meyer & Susman v. Cohen*, 194 Cal. Rptr. 180, 187-88 (Cal. Ct. App. 1983).

74. *Id.* at 188.

75. *Id.* at 192.

76. A more narrow interpretation of *Cadwalader* is that there would have been no recovery if the partnership agreement had an expulsion clause.

not discuss an appropriation of partnership business, old or new. The decision appears to jump straight from a finding of improper motive to a conclusion that partners breached their fiduciary duties.⁷⁷

The uncertainty and controversy around the doctrine of bad faith dissolutions belies the suggestion that the law of partnership breakups was clear and predictable under the UPA.⁷⁸ I agree that there are clear "right results" under the UPA, but *Cadwalader* is not one of them. Prior to *Cadwalader*, there was scant authority for the proposition that a dissolution and reformation is actionable simply because it is profit motivated.⁷⁹

Judge Cook's suggestion that law partners are not in a profit-maximizing business relationship is contrary to the expectation in many firms. It is true that many lawyers are troubled when the practice of law is viewed as a business rather than as a profession. To others, the recognition that law is a business is a precondition to positive change.⁸⁰ In a variety of ways, courts

77. A more narrow interpretation of *Cadwalader* is that the court jumped from a finding of an unauthorized expulsion to a breach of fiduciary duty.

78. Professor Hillman is emphatic on the mischief he sees in this line of cases:

The dictum in *Page* that a "partner may not dissolve a partnership to gain the benefits of the business for himself, *unless he fully compensates his co-partner for his share of the prospective business opportunity*" assumes immense significance if applied as a principle regulating the relationship between law partners. By adding the gloss that fiduciary responsibilities, in the form of a good-faith standard, restrain the decision to dissolve a terminable-at-will law partnership, the court in *RMS I* added to the mischief of *Page* . . . in ways that it probably never imagined, invited litigation in connection with partnership dissolutions, and laid the foundation for chaotic development of dissolution principles as applied to professional associations.

HILLMAN, *supra* note 23, § 4.6.3.2.

79. *Cf.* *Bohatch v. Butler & Binion*, 905 S.W.2d 597, 603 (Tex. App. 1995, writ granted) (stating that "within the context of an expulsion, partners must not act in bad faith, i.e., for self gain"). The court stated, "The issue is not whether the firm or the three partners [who were especially implicated in the expulsion] in fact gained an additional benefit by expelling [the partner] from the firm, but whether they *intended* to gain an additional benefit by doing so." *Id.* However, the court applied a *de minimis* test, concluding that the interest of the expelled partner "was so small . . . that the jury could not have reasonably concluded that the partners' expulsion of [her] was *motivated* by their desire to acquire her partnership share." *Id.* at 604; *see also Heller v. Pillsbury Madison & Sutro*, 58 Cal. Rptr. 2d 336, 348 (Cal. Ct. App. 1996). The *Heller* court concluded, "While his expulsion from the firm increased all Pillsbury partners' profit shares, given the large number of partners in 1992 and the fact that [the expelled partner] was earning toward the lower end of the firm's compensation range, the increase was insubstantial." *Id.* On the other hand, in a firm of few partners, the extinguishment of a profit share might receive greater scrutiny. *See Starr v. Fordham*, 648 N.E.2d 1261 (Mass. 1995).

80. *See generally* Russell G. Pearce, *The Professionalism Paradigm Shift: Why Discarding Professional Ideology Will Improve the Conduct and Reputation of the Bar*, 70 N.Y.U. L. REV. 1229 (1995).

have come to treat law firms as businesses.⁸¹ One leading law firm breakup case states that the "lifeblood of any partnership contains two essential ingredients, cash flow and profit."⁸² More recently, the New York Court of Appeals stated that law firms can have goodwill apart from the goodwill of constituent members. Earlier dictum to the contrary "has been superseded by the economic realities of the contemporary practice of law, illustrated by attorney advertising, internationalization of law firms, and other professional developments."⁸³

The reasonable expectations of the partners should control whether a dissolution is in bad faith. Partners and firms have very different attitudes and expectations with respect to the role of profit in their relationship. Some firms are intensely competitive in purely financial terms. Other firms hold themselves out as advancing other values. In the latter kind of firm, there may be a reasonable expectation of a heightened duty toward individual partners. As mentioned earlier, Cadwalader's partnership agreement supports an argument that the partners made an extraordinary commitment to one another. By their agreement, they may have undertaken both the benefits and the burdens of an extraordinary duty to be mutually supportive, professionally and financially. The law in this area should enforce such an agreement, but it should not assume that everyone has made one, nor should it impose one in the face of contrary expectations.⁸⁴ Indeed, in some firms it is arguable that an unprofitable partner has a duty to withdraw. In examining the reasonable expectations in a particular firm, the behavior of the partners is as important as their written agreement.⁸⁵

81. See *Howard v. Babcock*, 863 P.2d 150, 159 (Cal. 1993) (stating that "the assertion that the practice of law is not comparable to a business [is] unpersuasive and unreflective of reality").

82. *Lawlis v. Kightlinger & Gray*, 562 N.E.2d 435, 442 (Ind. Ct. App. 1990). The court in *Lawlis* rejected a partner's claim that he was expelled for "a predatory purpose," even though there was a "Five Year Plan" intended to "improve our lawyer to partner ratio and improve our profit per partner to production per lawyer ratio." *Id.* at 441 n.2. On the other hand, the expelling partners had worked with the expelled partner in his struggle with alcoholism and had carried him for a period at reduced compensation.

83. *Dawson v. White & Case*, 672 N.E.2d 589, 593 (N.Y. 1996).

84. See *Heller*, 58 Cal. Rptr. 2d at 348 (rejecting expelled partner's claim of breach of fiduciary duty). In *Heller*, the court stated:

[T]he Executive Committee expelled [him] because of a loss of trust in him. "The foundation of a professional relationship is personal confidence and trust. Once a schism develops, its magnitude may be exaggerated rightfully or wrongfully to the point of destroying a harmonious accord. When such occurs, an expeditious severance is desirable. To imply terms not expressed in this partnership agreement frustrates the unambiguous language of the agreement and the result contemplated."

Id. (citation omitted).

85. Under RUPA section 101(5), the partnership agreement "means the agreement,

3. The Powerful Liquidation Right

In a partnership without a continuation agreement,⁸⁶ the most powerful right is the right to demand a liquidation of the business. This liquidation right has long been a right under the UPA, existing in the absence of a contrary agreement. Although the right is not in doubt, it has been controversial. Critics urged the drafters of RUPA to eliminate the right.⁸⁷ The critics argued that it gives too much power to minority partners.⁸⁸ One opponent argued that it is not necessary to give partners the right to "dynamite" the business because other rights, such as a buyout right, sufficiently protect the minority partner's interests. Despite these objections, RUPA retained the liquidation right as the best way to force dominant partners to the bargaining table. The dominant partners in *Cadwalader* apparently refused to acknowledge Mr. Beasley's place at the table.

4. Negotiating in Good Faith

Partners need not be selfless when negotiating a breakup. On the other hand, they are not permitted to cross the line into bad faith.⁸⁹ The Fifth

whether written, oral or implied, among the partners concerning the partnership, including amendments. . . ." RUPA § 101(5).

86. The right to liquidate the business may be contracted away. See UPA § 38(2)(b); see also *supra* note 30 and accompanying text (suggesting that, in some jurisdictions, parties may be able to contract away dissolution itself and not merely its default consequences).

87. See Larry E. Ribstein, *A Statutory Approach to Partner Dissociation*, 65 WASH. U. L.Q. 357, 376-77 (1987). Professor Ribstein states:

In general, the U.P.A. approaches partner dissociation by blowing apart the partnership through mandatory dissolution and by giving each partner a right in most instances to compel liquidation, reserving the more limited buyout right to a few specific situations. Mandatory dissolution is costly because it may disrupt relationships with and rights of those who are dealing with the firm at the time of dissolution. . . . The question . . . is whether the costs associated with the U.P.A. "dynamite" approach are optimal in light of the benefits of this approach in effecting dissociation.

Id.

88. Cf. *id.* at 393-94. Professor Ribstein noted that:

It has been said that a negative aspect of the liquidation right is that it destroys the going concern value of the firm. . . . The more important problem with the liquidation right is that, as compared with buyout, the liquidation right makes it easier for the stronger partner to take over the business.

Id.

89. See Robert S. Summers, "Good Faith" in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 210-12 (1968) (referring to "openly abusing the power to break off negotiations" as example of legally proscribed bad faith).

Circuit in *Exxon Corp. v. Burglin*⁹⁰ recently discussed the parameters of bargaining on breakup.⁹¹ With respect to process, the court emphasized that "the standard of conduct for a general partner is somewhat lower when acting in an adversarial relationship"⁹² with the other partners, such as attempting to buy them out: "In this case . . . Exxon was buying out the limited partner's interests. It is logical to expect that the relationship would be somewhat adversarial. The limited partners must have realized that Exxon would try to secure the best deal it could and that this goal was adverse to their interests."⁹³ The court in *Exxon* emphasized that it was addressing a situation involving highly sophisticated parties bargaining with the assistance of counsel.⁹⁴

With respect to substance, the Fifth Circuit said that it will not invalidate an outcome simply because it is unfavorable to one of the partners: "Taking advantage of a party's inclination to accept an offer does not transform an *unfavorable* offer into an *unfair* one."⁹⁵ In response to the assertion by the limited partners that the general partner owed them a "duty to pay a fair price," the court said that the duty⁹⁶ had been contracted away:

The duty to pay a fair price was abrogated specifically by . . . the Partnership Agreement, which provides, "[I]f the General Partner is interested in acquiring [the] interest, both shall negotiate in good faith in an attempt to arrive at mutually agreeable terms of purchase." Thus, Exxon was required only to bargain in good faith; when parties negotiate in good faith and reach a mutually agreeable purchase price, the result of such a transaction cannot be upset by appeal to the concept of an objectively "fair" price.⁹⁷

90. 4 F.3d 1294 (5th Cir. 1993).

91. See *Exxon Corp. v. Burglin*, 4 F.3d 1294, 1299 (5th Cir. 1993).

92. *Id.* at 1301.

93. *Id.*

94. *Id.* at 1299.

95. *Id.* at 1301.

96. See generally *Jerman v. O'Leary*, 701 P.2d 1205 (Ariz. Ct. App. 1985). *Jerman* involved a general partner who had the right to purchase partnership property without the consent of any of the limited partners. Moreover, the partnership agreement authorized the general partner to buy or to sell partnership property "upon terms which the General Partner shall determine in its sole discretion." *Id.* at 1209 (citation omitted). Nevertheless, the court said that the general partner was "obliged to pay fair market value for the 25 acres and not to conceal . . . any facts . . . which would bear upon the question of fair market value." *Id.* at 1210.

97. *Exxon*, 4 F.3d at 1301 (citations omitted). Indeed, the case is all the more striking because it involved a claim by the limited partners that information necessary to bargain effectively had been held from them. The court said that the information had not been

On the other hand, absent a waiver, there is a duty to pay a fair price. Courts may view the actions of partners in negotiating the buyout of another partner as self-dealing, such that they will scrutinize the fairness of the buyout price. In *Starr v. Fordham*,⁹⁸ a law firm's founding partners relied on their authority under the partnership agreement to determine, prospectively and retrospectively, each partner's share in profits.⁹⁹ The court said that the founding partners were self-interested "because the percentage of profits which they were assigning to the other partners had a direct effect on their own percentage of the profits."¹⁰⁰ Therefore, the business judgment rule did not apply and the founding partners had the burden of proving the fairness of their allocation.¹⁰¹

III. RUPA's Fiduciary Duty and Related Rules

A. Introduction

RUPA's fiduciary duty and related rules reflect more continuity than change in *Cadwalader*-type situations. RUPA provides two kinds of rules that govern the relations among partners. First, RUPA has "default" rules that apply like default settings on a computer — they apply only if no other rules, or settings, have been selected by a user, in this case by a user of the partnership form. Second, RUPA contains "mandatory" rules the parties may not contract away in their partnership agreement. The mandatory rules appear in section 103(b). Different duties are subject to different mandatory minima. Some duties may not be "varied," others may not be "unreasonably restricted," others may not be "unreasonably reduced," and others may not be "eliminated."¹⁰²

improperly withheld because the partnership agreement gave the general partner discretion to classify certain information as confidential and to withhold it. *Id.* "If the price was not fair, the limited partners need not have accepted the offer. Exxon did not violate its obligation to negotiate in good faith by allegedly withholding valuable information that it was under no duty to disclose." *Id.*

98. 648 N.E.2d 1261 (Mass. 1995).

99. See *Starr v. Fordham*, 648 N.E.2d 1261, 1264 (Mass. 1995).

100. See *id.* at 1265; see also *Smith v. Brown & Jones*, 633 N.Y.S.2d 436, 441 (N.Y. Sup. Ct. 1995) (stating that "the court can consider the self-interest of the partnership in assigning an artificially low value to a departing partner's share").

101. On the other hand, the court permitted the founding partners to offset the profit share of the withdrawing partner by his share of the firm's rental obligation under its long-term office lease.

102. See RUPA § 103(b). For a defense of RUPA's mandatory minima, see generally Donald J. Weidner, *RUPA and Fiduciary Duty: The Texture of Relationship*, 58 LAW & CONTEMP. PROBS. 81 (Spring 1995).

By far the most controversial of RUPA's mandatory rules are those concerning the fiduciary duties of partners and the related obligation of good faith and fair dealing. RUPA's rules on the fiduciary duties of partners are mostly default rules with discrete mandatory minima. Because the drafters intended RUPA to give partners greater flexibility to agree to limit their fiduciary duties, the mandatory minima are extremely permissive.

RUPA's core fiduciary duty provision is section 404, which sets out the duties that RUPA classifies as fiduciary duties together with other rights and obligations. One must read section 404 in conjunction with section 103(b), which explains the extent to which the section 404 and other rules may be varied or eliminated. Section 404 also includes an overarching obligation of good faith and fair dealing, which falls outside of section 404's definition of fiduciary duties. Also outside of RUPA's definition of fiduciary duties are section 403's duties to provide access to books and records and to provide other information.

B. Nine Fiduciary Duty Rules

RUPA's fiduciary duty provisions can be stated as nine separate rules.

Rule #1: Every partner has fiduciary duties to the partnership and to the other partners.¹⁰³ This rule differentiates partnerships from limited liability companies (LLCs), in which not all members have duties to other members or to the company. In the case of manager-managed LLCs, non-managing members have no duties to the other members or to the organization.¹⁰⁴ RUPA has one set of rules that applies to all partners, both to managing partners and to non-managing partners, although case law puts managers under a heightened duty.¹⁰⁵

Is there a breach of a fiduciary duty every time there is a breach within a relationship that is categorized as a fiduciary relationship? RUPA's answer is clearly "no." Under RUPA, partners have a wide range of duties under the partnership agreement and under the statute. The statute makes clear that the relationship is bifurcated. RUPA distinguishes a partner's fiduciary duties from the partner's other duties and obligations. Very few duties are fiduciary duties. The basic message of the statute is that partnership is a contractual relationship in which there are limited fiduciary duties.¹⁰⁶

103. See RUPA §§ 404(a)-(c).

104. See UNIFORM LIMITED LIABILITY COMPANY ACT § 409(h)(1), 6A U.L.A. 464 (1995) [hereinafter ULLCA] (stating that "a member who is not also a manager owes no duties to the company or to the other members solely by reason of being a member").

105. See *Meinhard v. Salmon*, 164 N.E. 545, 548 (N.Y. 1928). "[Salmon] was much more than a coadventurer. He was a managing coadventurer. For him and for those like him the rule of undivided loyalty is relentless and supreme." *Id.* (citations omitted).

106. See *Bohatch v. Butler & Binion*, 905 S.W.2d 597, 601-02 (Tex. App. 1995, writ

RUPA does not make clear the significance of classifying an obligation as a fiduciary duty. For example, assume that in *Cadwalader* the dominant partners breached the partnership agreement by failing to acknowledge Mr. Beasley's right to a liquidation. Is it important to ask whether the breach is a violation of a fiduciary duty? Does it matter at all?

Traditionally, a contract embracing a fiduciary relationship is treated specially. The law of agency¹⁰⁷ states that agency "is both a consensual and a fiduciary relation."¹⁰⁸ Although the agency relation normally involves a contract, "it is a special kind of contract, since an agent is not merely a promisor or a promisee but is also a fiduciary."¹⁰⁹ This means that the agent's "duties are similar to those of a testamentary trustee to the beneficiaries."¹¹⁰ Any "gaps" in the contract are filled with this in mind,¹¹¹ and specific provisions are interpreted with this in mind.¹¹² Doubts are resolved against the fiduciary.¹¹³

In addition, because of the fiduciary nature of the relation, one may enforce the duties of an agent not only with contract remedies, but also with tort remedies:

[U]nlike most other contracting parties, the agent may be subject to tort liability to the principal for failing to perform his duties. If the agent . . . acts disobediently causing harm to the principal's interests, an action of tort will lie against him, as it will if he violates a duty of loyalty to the

granted) (following UPA). The appellate court reversed a punitive damage award in a wrongful expulsion case "[b]ecause we find the firm breached the partnership agreement but did not breach a fiduciary duty" *Id.* at 599.

107. Compare RUPA § 301 (providing that every partner is an agent of the partnership), with ULLCA § 301(b)(1) (providing that "a member is not an agent of the company for the purpose of its business solely by reason of being a member").

108. RESTATEMENT (SECOND) OF AGENCY, Ch. 13, Topic 1, Introductory Note (1957).

109. *Id.*

110. *Id.*

111. *Id.* The RESTATEMENT (SECOND) OF AGENCY states that:

[S]ince the contract of employment, if there is one, is ordinarily not spelled out in detail but depends for its interpretation upon evidence as to the customary way of doing business, the generalizations which can be drawn concerning the agent's duties are inferences of fact which are permissible only in the absence of a specific understanding otherwise.

Id.

112. *Id.* "Even specific agreements, however, must be interpreted in the light of the principles which are applicable to the relation of principal and agent." *Id.*

113. See *Konover Dev. Corp. v. Zeller*, 635 A.2d 798, 804 (Conn. 1994) (stating that promises of managing general partner "were impressed with a fiduciary duty" that imposed burden of proving fair dealing by clear and convincing evidence).

principal by improperly competing with him or otherwise. In all of these situations his liability extends beyond the area of contractual obligation so that normally the principal will have a choice between maintaining an action for a breach of contract or for a tort.¹¹⁴

On the other hand, as Professor Hynes has stressed, the Restatement of Agency is permeated with language that the agent's fiduciary duties are "dependent upon the nonexistence of an agreement to the contrary."¹¹⁵

To the extent that fiduciary obligations are more supportive of punitive damages than other contractual obligations, characterizing the wrong can be important.¹¹⁶ *Cadwalader's* conclusion that an appropriation had taken place in violation of fiduciary duties is more supportive of an award of punitive damages than is a conclusion that the firm had overlooked a non-fiduciary procedural nicety.¹¹⁷ One can view appropriation of a partnership opportunity as theft. It has on occasion been treated as a moral wrong for disciplinary law¹¹⁸ and criminal law purposes.¹¹⁹ The three basic purposes of punitive

114. RESTATEMENT (SECOND) OF AGENCY, Ch. 13, Topic 1, Introductory Note (1957).

115. J. Dennis Hynes, *Freedom of Contract, Fiduciary Duties, and Partnerships: The Bargain Principle and the Law of Agency*, 54 WASH. & LEE L. REV. 439, 446 (1997); see also RESTATEMENT (SECOND) OF AGENCY § 376 cmt. a (1957). The RESTATEMENT notes:

[T]he duties . . . of loyalty are inferences drawn from the conduct of the parties in light of common experience and what reasonable men regard as fair. . . . Since the parties can make what agreements they please, and since . . . such agreements are enforceable, the [duty of loyalty] rules . . . are . . . dependent upon the nonexistence of an agreement to the contrary.

Id.

116. The partners may contract with respect to dispute resolution and with respect to the availability of punitive damages as a remedy. See *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 58 (1995).

[O]ur decisions . . . make clear that if contracting parties agree to *include* claims for punitive damages within the issues to be arbitrated, the [Federal Arbitration Act] ensures that their agreement will be enforced according to its terms even if a rule of state law would otherwise exclude such claims from arbitration. *Thus, the case . . . comes down to what the contract has to say about the arbitrability of petitioner's claim for punitive damages.*

Id. (emphasis added); see also *Moncharsh v. Heily & Blase*, 832 P.2d 899 (Cal. 1992); *Hackett v. Milbank, Tweed, Hadley & McCloy*, 654 N.E.2d 95 (N.Y. 1995).

117. See *Bohatch v. Butler & Binion*, 905 S.W.2d 597, 599 (Tex. App. 1995, writ granted) (reversing award of punitive damages "[b]ecause we find the firm breached the partnership agreement but did not breach a fiduciary duty"); see also *Heller v. Pillsbury Madison & Sutro*, 58 Cal. Rptr. 2d 336, 350 (Cal. Ct. App. 1996) (stating that punitive damages are recoverable for breach of fiduciary duty but that claim requires "clear and convincing" evidence and not merely preponderance of evidence).

118. Partners who are attorneys may be subjected to additional consequences for breaching fiduciary duties, even if the breach falls outside the attorney-client relationship. In one

damages are to assure sufficient compensation to the aggrieved individual, to punish the wrongdoer and to deter similar wrongdoing.¹²⁰ *Cadwalader* is typical of many cases in which the exact purpose of the punitive damages is unclear,¹²¹ even though when and how judges submit punitive damage awards to juries are critical.¹²²

On the other hand, RUPA contains no rules that expressly bifurcate available remedies. In addition, an analysis that requires a determination of whether a fiduciary duty exists in order to decide choice of remedy is excessively formalistic and fails to appreciate the overlapping nature of tort and contract.¹²³ The remedy issue is one aspect of RUPA's larger theme —

case, an attorney appropriated to his own use a portion of the attorneys' fees he should have been sharing with his partners. See *Committee on Professional Ethics and Conduct v. McClintock*, 442 N.W.2d 607, 607 (Iowa 1989). The Grievance Commission found, among other things, that the attorney had committed "illegal conduct involving moral turpitude." *Id.* The Supreme Court reprimanded the attorney, stating: "[M]ost law partnerships are founded upon a total trust and confidence among the partners. A breach of this exceedingly close relationship merits disciplinary action. Although [his] conduct did not involve an attorney-client relationship, his conduct is governed by the Code of Professional Responsibility." *Id.* at 608.

119. See *HILLMAN ET AL.*, *supra* note 5, at 51.

An important criminal law consequence was intended to follow from the declaration that the partnership as an entity, rather than the partners as co-owners, owns partnership property. One purpose of the move was to make clear that partners who embezzle from partnerships are subject to the same criminal penalties as shareholders who embezzle from corporations.

Id.

120. This is also true in the case of a business organization that is being held vicariously liable for the behavior of an agent. See Gary T. Schwartz, *Deterrence and Punishment in the Common Law of Punitive Damages: A Comment*, 56 S. CAL. L. REV. 133, 136 (1982). "If punishment is the chief purpose of punitive damages, then the criminal law model should prevail and vicarious liability should be rejected. But if deterrence is the principal purpose, the tort law model seems controlling, and vicarious liability can be endorsed." *Id.*

121. Given that punishment and deterrence are different purposes, the terms "punitive" and "exemplary" may have different meanings. Nevertheless, on occasion courts use them interchangeably. See *Jerman v. O'Leary*, 701 P.2d 1205 (Ariz. 1985); *Bohatch v. Butler & Binion*, 905 S.W.2d 597 (Tex. App. 1995, writ granted).

122. In *Bohatch*, the jury awarded an expelled partner \$4 million in punitive damages against three members of the firm's management committee. See *Bohatch*, 905 S.W.2d at 600. The trial court reduced the punitive damage award to \$237,141. *Id.* at 601. The intermediate appellate court eliminated them completely, reasoning that punitive damages were inappropriate because, although the defendants breached the partnership agreement, they did not breach any fiduciary duties. *Id.* at 608.

123. See Claire Moore Dickerson, *From Behind the Looking Glass: Good Faith, Fiduciary Duty and Permitted Harm*, 22 FLA. ST. U. L. REV. 955, 978-93 (1995) (discussing good faith and fiduciary duty continuum).

to restrain the application of the law of fiduciary duties. This is the stuff of rules 2 and 3.

Rule #2 and Rule #3: Rule #2 states that the *only* fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care that are defined in the statute.¹²⁴ One can best understand this rule in conjunction with Rule #3, which states that a partner has a duty of loyalty that "is limited to" the duty to account for partnership opportunities, the duty to refrain from dealing as or on behalf of an adverse party, and the duty to refrain from competing with the partnership prior to dissolution.¹²⁵ These two rules are RUPA's most controversial provisions and are the ones most likely to be modified by adopting states.¹²⁶

The basic purpose of the exclusive listing approach to fiduciary duties is to instruct the courts: (1) refrain from creating new duties under the rubric of fiduciary obligation;¹²⁷ (2) permit recognized fiduciary duties to be restricted by agreement; and (3) treat the specified fiduciary duties, and only these duties, as supporting tort remedies in addition to contract remedies.¹²⁸ As discussed below, many consider the duty of good faith and fair dealing and the duty to provide information, neither of which appears on RUPA's exclusive list of fiduciary duties, to be important aspects of a partner's fiduciary duties.

124. RUPA § 404(a).

125. RUPA § 404(b).

126. California eliminated the exclusive statement aspect of Rules 2 and 3. The word "only" was deleted from California's adoption of RUPA section 404(a) and the duty of loyalty is not "limited to" but "includes" the components listed in RUPA section 404(b). See CAL. CORP. CODE § 16404(a), (b) (flush language) (West 1996). In Florida, the "only" was retained in RUPA section 404(a), but the RUPA section 404(b) duty of loyalty is stated to include, "without limitation," the components specified in RUPA section 404(b). See FLA. STAT. ANN. § 620.8404 (West 1997).

127. Cf. *Bohatch v. Butler & Binion*, 905 S.W.2d 597, 602 (Tex. App. 1995, writ granted) (stating that "partners have a general fiduciary duty not to expel other partners from the partnership in bad faith"). On the other hand, *Bohatch* rejected a jury finding that three managing partners "breached a fiduciary duty 'with an intent to gain additional benefit.'" *Id.* at 600 (citations omitted).

128. See Vestal, *supra* note 4, at 530. Professor Vestal states: "RUPA overall adopts a much more contractarian orientation than does the UPA, although the transition is imperfect. . . . It seems clear that the fiduciary duties of partners under the UPA and common law are matters essentially of status and not agreement, of tort and not contract." *Id.* But see Hynes, *supra* note 115, at 452; Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537, 538-39 (1997). Professors Hynes and Ribstein take the opposite position. They believe that contract always has been controlling and that RUPA has added mandatory fiduciary minima that did not exist under the UPA.

Rule #4: A partner is not the sort of fiduciary who must behave as a disinterested trustee.¹²⁹ Judge Cook quoted Judge Cardozo's language in *Meinhard v. Salmon*,¹³⁰ to the effect that "[a] trustee is held to something stricter than the morals of the marketplace."¹³¹ According to Cardozo, the "standard of behavior" for such a trustee is "[n]ot honesty alone, but the punctilio of an honor the most sensitive."¹³² This meant that "thought of self was to be renounced, however hard the abnegation."¹³³ RUPA reflects the judgment that it is inappropriately unrealistic to expect partners to renounce self-interest.¹³⁴ Section 404(e) codifies this judgment, providing that: "A partner does not violate a duty or obligation under this act or under a partnership agreement merely because the partner's conduct furthers the partner's interest."¹³⁵

Section 404(e) is a very different statement of the law than the statement in many judicial opinions that a partner's fiduciary duty requires abnegation of self. It reflects developments in corporate law¹³⁶ and was made part of the statute because of the influence of the work of Professor Robert W. Hillman. Professor Hillman's analysis is that the courts' actions speak much more softly than their words.¹³⁷ In particular, partners may pursue self-interest by rebargaining their relationship. The drafters of RUPA wanted statutory statement of the pursuit of self-interest that is legitimate under current case law. Inclusion of this principle reflects the policy judgment that overly broad statements of fiduciary duty tend to invite costly and wasteful litigation

129. Cf. *Riddle v. Harmon*, 162 Cal. Rptr. 530, 532 (Cal. Ct. App. 1980) (permitting joint tenant to secretly and unilaterally sever joint tenancy). In *Riddle*, the joint tenants were husband and wife and the severance arguably violated a contract to mutually plan their estates. *Id.*

130. 164 N.E. 545 (N.Y. 1928).

131. *Beasley v. Cadwalader, Wickersham & Taft*, No. CL-94-8646 "AJ," 1996 WL 438777, at *5 (quoting *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928)).

132. *Id.*

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

134. Cardozo himself thought the case law of his time offered little guidance in deciding particular cases: "Little profit will come from a dissection of the precedents." *Id.* at 547.

135. RUPA § 404(e).

136. See Lawrence E. Mitchell, *The Naked Emperor: A Corporate Lawyer Looks at RUPA's Fiduciary Provisions*, 54 WASH. & LEE L. REV. 465, 471 (1997). "[M]ost 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." *Id.*

137. See generally Robert W. Hillman, *Private Ordering Within Partnerships*, 41 U. MIAMI L. REV. 425 (1987). See also John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 629 (1995) (concluding that "despite decades of pulpit-thumping rhetoric about the sanctity of fiduciary obligations, fiduciary duties in trust law are unambiguously contractarian").

and threats of litigation,¹³⁸ including litigation by partners who are attempting to avoid some aspect of their partnership agreement.

Rule #5: One might refer to Rule #5 as the dual capacity, or nonpartner capacity rule. It authorizes partners to contract for the same rights as third parties with respect to selected aspects of the partnership business.¹³⁹ Section 404(f) provides: "A partner may lend money to and transact other business with the partnership, and as to each loan or transaction, the rights and obligations of the partner are the same as those of a person who is not a partner, subject to other applicable law."¹⁴⁰ The rule clarifies that "a partner may, for the partner's own account, purchase the assets of the partnership at a foreclosure sale or upon the liquidation of the partnership."¹⁴¹ This interpretation endorses case law in states such as Georgia on the narrow point of lender remedies,¹⁴² and also endorses case law from other states with regard to other transactions.¹⁴³

Rule #6: Section 103(b)(3) provides that the partnership agreement may not "eliminate" the duty of loyalty, but it "may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable."¹⁴⁴ The drafters clearly intended to prevent a categorical waiver of the duty of loyalty. To this extent, the drafters saw themselves as codifying existing law.¹⁴⁵

On the other hand, RUPA permits a very general *ex ante* restriction of the duty of loyalty. It is clear that, except in extreme situations, the partnership agreement may limit narrowly the fiduciary duties of partners¹⁴⁶ with

138. Cf. Lawrence E. Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675, 1696 (1990) (approving *Meinhard's* "aspirational and studiously imprecise" language).

The very ambiguity of the language conveys its moral content as the court's refusal to set lines is designed to discourage marginal conduct by making it difficult for a fiduciary to determine the point at which self-serving conduct will be prohibited, and thus to encourage conduct well within the borders.

Id.

139. The Internal Revenue Code also provides that, for certain purposes, partners may treat transactions between partnership and partner as transactions between unrelated parties. See I.R.C. § 707 (1996).

140. RUPA § 404(f).

141. RUPA § 404 cmt. 6.

142. See *Westminster Properties, Inc. v. Atlanta Assocs.*, 301 S.E.2d 636, 638-39 (Ga. 1983).

143. *Cude v. Couch*, 588 S.W.2d 554, 555-56 (Tenn. 1979) (including strong dissent).

144. RUPA § 103(b)(3)(i).

145. RUPA § 103 cmt. 4 (citing *Labovitz v. Dolan*, 545 N.E.2d 304 (Ill. 1989)).

146. Some partners may want to leave the default rules in place, or even strengthen them.

respect to specific types or categories of activities.¹⁴⁷ The restriction need not be transaction specific. For example, a partnership agreement may permit a general partner in a real estate partnership to trade for the partner's own account without prior disclosure and without offering opportunities to the partnership.¹⁴⁸

Rule #7: RUPA provides for *ex ante* and *ex post* approval of specific transactions: "[A]ll of the parties or a number or percentage specified in the partnership agreement may *authorize or ratify*, after full disclosure of all material facts, *a specific act or transaction* that otherwise would violate the duty of loyalty."¹⁴⁹ Even prior to RUPA, partners could authorize specific transactions in advance. In *Riviera Congress Associates v. Yassky*,¹⁵⁰ the court allowed the general partners in a limited partnership to release themselves from liability on a lease to their own thinly capitalized corporation.¹⁵¹ The court said that full disclosure in the prospectus had the effect of "exonerating" the general partners "from adverse inferences" that might otherwise have been drawn from the fact of self-dealing.¹⁵² Interestingly, the court did

First, some partners will want a more trusting relationship. Second, others inadvertently may cause themselves difficulty by eliminating too much of their fiduciary obligation. For example, in the case of a family limited partnership, eliminating the fiduciary duties of a general partner could require the general partner to include the interest of a limited partner in the general partner's gross estate under I.R.C. sections 2036, 2038 (1996). See Priv. Ltr. Rul. 93-10-1039 (Mar. 12, 1992); Priv. Ltr. Rul. 91-15-007 (Jan. 8, 1991).

147. See FLA. STAT. ANN. § 542.33 (West 1997) (limiting covenants that restrict competition).

148. RUPA § 103 cmt. 4. The comment explains:

A provision in a real estate partnership agreement authorizing a partner who is a real estate agent to retain commissions on partnership property bought and sold by that partner would be an example of a "type or category" of activity that is not manifestly unreasonable and thus should be enforceable under the Act. Likewise, a provision authorizing that partner to buy or sell real property for his own account without prior disclosure to the other partners or without first offering it to the partnership would be enforceable as a valid category of partnership activity.

Id.

149. RUPA § 103(b)(3)(ii) (emphasis added).

150. 223 N.E.2d 876 (N.Y. 1966).

151. See *Riviera Congress Assocs. v. Yassky*, 223 N.E.2d 876, 880 (N.Y. 1966).

152. *Id.* at 880. The court stated:

Ordinarily, . . . self-dealing would render the defendants incapable, as general partners, . . . from releasing themselves from liability on the lease However, partners may include in the partnership articles practically "any agreement they wish" and, if the asserted self-dealing was actually contemplated and authorized, it would not, *ipso facto*, be impermissible and deemed wrongful. . . . [T]he limited partners were fully apprised in the prospectus that the defendant general

not require that the disclosure be in a writing designated as the partnership agreement.¹⁵³

Although at first glance the new ratification rule appears to validate virtually all transaction-specific prior approvals and subsequent ratifications, the drafters did not intend this interpretation. The right to approve or ratify is subject to the obligation of good faith and fair dealing¹⁵⁴ and to analogous developments in the law of other business organizations. Courts should continue to scrutinize attempts by partners to validate their own behavior.¹⁵⁵ As discussed below, a more narrow interpretation of the ratification rule is appropriate in situations like *Cadwalader*.

Rules #8 and #9 concern the duty of care, which is of less importance in the *Cadwalader* scenario than the duty of loyalty and the obligation of good faith and fair dealing.¹⁵⁶

C. The Obligation of Good Faith and Fair Dealing

RUPA provides that all rights and duties are qualified by the obligation of good faith and fair dealing. Section 404 requires a partner to "discharge the duties to the partnership and the other partners under this [Act] or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing."¹⁵⁷ The partnership agreement may not eliminate the obligation of good faith¹⁵⁸ and fair dealing, but it "may

partners intended to lease the premises to their own [thinly capitalized] corporation This clear statement of purpose has the effect of "exonerating" the defendants, at least in part, "from adverse inferences which might otherwise be drawn against them" simply from the fact that they dealt with themselves.

Id. (citations omitted); see also *Bassan v. Investment Exchange Corp.*, 524 P.2d 233, 236-37 (Wash. 1974) (suggesting that, if partner is to enter into transaction with partnership, partner should disclose extent of profit).

153. RUPA section 101(5) defines the partnership agreement to be the entire understanding among the partners, "whether written, oral, or implied," not including nonpartner capacity understandings, such as leases or mortgages. See RUPA § 101 cmt.

154. See RUPA § 404 cmt. 4.

155. See *infra* Part IV.B.2 (discussing application of ratification rule in situations like *Cadwalader*).

156. The fact that most strongly suggests a duty of care issue is the failure to consult the firm's partnership experts. The RUPA standard is the duty to refrain from gross negligence. RUPA § 404(c). The agreement may not "unreasonably reduce" this duty. RUPA § 103(b)(4); see Donald J. Weidner, *Three Policy Decisions Animate Revision of Uniform Partnership Act*, 46 BUS. LAW. 427, 468 (1991).

157. RUPA § 404(d).

158. Professor Hynes believes that RUPA's definition of good faith is too broad for a mandatory rule:

prescribe the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable."¹⁵⁹

The basic purpose of RUPA's "obligation" of good faith and fair dealing rather than a "duty" of good faith and fair dealing is to assure that no new duties, fiduciary or otherwise, are created under the general rubric of good faith (with or without fair dealing). RUPA provides that "[t]he obligation of good faith and fair dealing . . . is not . . . a separate and independent obligation. It is an ancillary obligation that applies whenever a partner discharges a duty or exercises a right under the partnership agreement or the Act."¹⁶⁰

By statutory fiat, the "obligation of good faith and fair dealing" is *not* a fiduciary duty. Presumably this means that the "obligation" is merely contractual. It is true that longstanding authority suggests that good faith and fair dealing is a contractual duty.¹⁶¹ On the other hand, a considerable amount of case law exists that discusses good faith and fair dealing as a fiduciary duty.¹⁶² Case law also exists that discusses it as both.¹⁶³

A broad definition of good faith as a default duty is one thing; a broad definition of a mandatory term is quite another. It creates a risk of litigation over difficult decisions that may involve conflicting interests, and it can be exploited by a partner disappointed in the relationship who takes advantage of ambiguity and complexity and generates a dispute by claiming fellow partners acted in bad faith.

Hynes, *supra* note 115, at 450 n.47.

159. RUPA § 103(b)(5).

160. RUPA § 404 cmt. 4.

161. See RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979) (stating "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement"); see also *Oregon RSA No. 6, Inc. v. Castle Rock Cellular of Oregon L.P.*, 840 F. Supp. 770, 778 (D. Or. 1993), *aff'd*, 76 F.3d 1003 (9th Cir. 1996). "[T]he doctrine of good faith is not a new material term created by the court, but rather a term implied by law in every contract to give effect to the legitimate expectations of the parties that were created by the language of their contract." *Id.*

162. See *Lawlis v. Kightlinger & Gray*, 562 N.E.2d 435, 442 (Ind. Ct. App. 1990). "[T]he fiduciary duty owed between partners . . . requires each to exercise good faith and fair dealing in partnership transactions and toward co-partners." *Id.*; see also *Exxon Corp. v. Burglin*, 4 F.3d 1294, 1299 (5th Cir. 1993) (stating that "the contractual abrogation of some fiduciary duties does not relieve the general partner from other basic fiduciary duties, such as the duty of good faith and fair dealing" (citations omitted)). RUPA provides a similar mandatory minimum for the non-fiduciary obligation of good faith and fair dealing as it does for the fiduciary duty of loyalty. Compare RUPA § 103(b)(3)(i) (providing that partners may draft out of duty of loyalty specific types or categories of activities "if not manifestly unreasonable"), with RUPA § 103(b)(5) (providing that performance standards may define what falls outside obligation of good faith and fair dealing, "if . . . not manifestly unreasonable").

163. See *Starr v. Fordham*, 648 N.E.2d 1261, 1265, 1271 (Mass. 1995). The court noted: "Partners owe each other a fiduciary duty of the highest degree of good faith and fair deal-

It is clear enough how the obligation interacts with the duties RUPA considers contractual. It is not at all clear how it interacts with the duties RUPA classifies as fiduciary. For example, what does it mean to say that there is "merely" a contractual obligation to use good faith and fair dealing to carry out the fiduciary duty of loyalty? Does this mean that tort remedies are appropriate if one violates the black-letter of the duty but inappropriate if one violates the interstitial "obligation"? Presumably, the obligation takes on the nature of the underlying right or duty. If the obligation qualifies a fiduciary duty, it takes on the nature of a fiduciary obligation, and tort remedies are appropriate. If it qualifies a right or a duty that is merely contractual, tort remedies are not appropriate.

RUPA states that there is no "firmly fixed" meaning of good faith and fair dealing: "'Good faith' clearly suggests a subjective element, while 'fair dealing' implies an objective component. It was decided to leave the terms undefined in the Act and allow the courts to develop their meaning" ¹⁶⁴ The Comments to RUPA state that good faith is an "excluder" that has no general meaning of its own. ¹⁶⁵ They also state that the obligation of good faith and fair dealing includes a disclosure component that supplements the RUPA section 403 duty to furnish information. ¹⁶⁶

D. Information Rights

RUPA's definition of the fiduciary duties of partners is underinclusive to the extent that it does not include the duty to provide information. Courts

ing. . . . The implied covenant of good faith and fair dealing is a contractual obligation." *Id.*

164. RUPA § 404 cmt. 4. The drafters rejected the UCC definitions of good faith: "The UCC definition of 'good faith' is honesty in fact and, in the case of a merchant, the observance of reasonable commercial standards of fair dealing in the trade. Those definitions were rejected as too narrow or not applicable." *Id.* (citations omitted). With respect to the objective and subjective aspects, see *Kansas City Power & Light Co. v. Ford Motor Credit Co.*, 995 F.2d 1422, 1431 (8th Cir. 1993). The court noted that "even drafters of the U.C.C. have believed that the U.C.C.'s definition of good faith contains both objective and subjective components and that, at any rate, the difference between 'subjective' and 'objective' standards is often minimal in practice." *Id.*

165. See RUPA § 404 cmt. 4.

Good faith . . . is best understood as an "excluder" — a phrase with no general meaning or meanings of its own. Instead, it functions to rule out many different forms of bad faith. It is hard to get this point across to persons used to thinking that every word must have one or more general meanings of its own — must be either univocal or ambiguous.

Id.

166. See *id.* "In some situations the obligation of good faith includes a disclosure component. Depending on the circumstances, a partner may have an affirmative disclosure obligation that supplements the Section 403 duty to render information." *Id.*

and commentators have long considered the duty to provide information to be an important aspect of a partner's fiduciary duties,¹⁶⁷ although the UPA did not expressly designate it as a fiduciary duty.¹⁶⁸

Ironically, even though RUPA does not recognize the duty to provide information as a "fiduciary" duty, it makes the duty stronger than it was under the UPA.¹⁶⁹ Indeed, the one area in which RUPA has expanded what courts traditionally considered fiduciary obligation has been in information rights. Section 403 provides:

(b) A partnership shall provide partners . . . access to its books and records . . .

(c) *Each partner and the partnership shall furnish to a partner . . .*

(1) *without demand, any information concerning the partnership's business and affairs reasonably required for the proper exercise of the partner's rights and duties under the partnership agreement or this [Act]; and*

(2) *on demand, any other information concerning the partnership's business and affairs, except to the extent the demand . . . is unreasonable or otherwise improper under the circumstances.*¹⁷⁰

167. Because the duty to provide information often has been considered a core fiduciary duty, the kind of non-uniform provisions that are being enacted with respect to fiduciary duties also can be expected with respect to information duties. For example, Florida law states that the partnership agreement may not "[u]nreasonably restrict the right of access to books and records under section 620.8403(2) and (3)." FLA. STAT. ANN. § 620.8103(2)(a)(2) (West 1997). The words of section 620.8103(2)(a)(2) refer only to the right of access to books and records but the numerical references of section 620.8103(2)(a)(2) include specific references both to subsection (2), dealing with books and records, and to subsection (3), dealing with the duty to furnish "any information," upon demand and without demand. *Id.* Stated differently, under Florida's version of RUPA, partnerships may not unreasonably restrict the duty to disclose without demand.

168. Compare UPA § 20, with UPA § 21.

169. The duty is stronger with respect to the partnership and with respect to other partners. RUPA is stingy with information rights for transferees. See RUPA § 503(a)(3). RUPA provides that a transfer of a partner's transferable interest in the partnership "does not . . . entitle the transferee, during the continuance of the partnership, to . . . require access to information concerning or an account of partnership transactions, or to inspect or copy the partnership books or records." *Id.*; see *Bauer v. The Bloomfield Co./Holden Joint Venture*, 849 P.2d 1365 (Alaska 1993); LARRY E. RIBSTEIN, UNINCORPORATED BUSINESS ENTITIES 134 (1996). Professor Ribstein states:

The assignee relies, in effect, on her contract with the assignor partner, who may agree to exercise her own rights on behalf of the assignee. Even if the assignor does not explicitly agree to protect the assignee, a court might hold that such a duty is implicit in an assignment of economic rights, since the rights would be worthless without it.

Id. But see TEX. REV. CIV. STAT. ANN. art. 6132b, § 27(1) (West 1970) (providing that assignee is entitled "for any proper purpose, to require reasonable information or account of partnership transactions and to make reasonable inspection of the partnership books").

170. RUPA § 403 (emphasis added).

The big change in section 403 is the elimination of the need to make a demand for information. Because section 403 states a duty to provide information "without demand," it constitutes a powerful new affirmative duty to disclose. Both sides in *Cadwalader* could have argued that the other side should have furnished information necessary for the proper exercise of their rights and duties.

Although RUPA prohibits a partnership agreement from unreasonably restricting the section 403(b) right of access to books and records,¹⁷¹ it permits the partnership agreement to eliminate the section 403(c) information rights.¹⁷² On one hand, the right to withhold information is subject to the obligation of good faith and fair dealing, leaving the courts a statutory basis for imposing minimal disclosure obligations. On the other hand, the drafters did not intend RUPA's "obligation" of good faith and fair dealing to be a talisman for creating new rights or duties.

IV. *Cadwalader Revisited Under RUPA*

A. *RUPA's Basic Policies Are Unchanged*

RUPA does little to change the result in *Cadwalader*, either by its fiduciary duty and related rules or by its rules on partnership breakups. Although RUPA uses language of contract to restrict fiduciary duties, it reflects the substance of holdings under the UPA that partners have great freedom to define their relationship.¹⁷³ A rich body of case law has developed around the general notion that partners are fiduciaries. Much of it antedated the use of the word fiduciary in the title to UPA section 21. Indeed, it is not clear that the UPA had any significant influence on the development of the law of partners as fiduciaries. Courts will import wholesale much of the UPA case law into the interpretation of RUPA, and corporate law will continue to provide useful analogies. Courts may restate much of this law in terms of the section 404(d) obligation of good faith and fair dealing.

RUPA contains new rules to clarify the winding down of a partner's fiduciary duties. These rules distinguish among the components of the duty of loyalty. Dissociation terminates a partner's duty to refrain from competing with the partnership.¹⁷⁴ The duty to account for benefits and opportuni-

171. RUPA § 103(b)(2).

172. Cf. *Exxon Corp. v. Burglin*, 4 F.3d 1294, 1299 (5th Cir. 1993) (permitting contracting-out of disclosure obligations by sophisticated parties in negotiated transaction).

173. See Ribstein, *supra* note 128, for an analysis of the UPA case law approving contracting-out of fiduciary duties.

174. RUPA §§ 603(b)(2), 404(b)(3).

ties continues, as does the duty to refrain from dealing as or on behalf of an adverse party, but "only with regard to matters arising and events occurring before the partner's dissociation, unless the partner participates in the winding up of the business" ¹⁷⁵ Although these provisions raise questions of interpretation, ¹⁷⁶ the drafters did not intend to change current law. ¹⁷⁷ Under RUPA, as under the UPA, partners in *Cadwalader*-type situations are under a fiduciary duty to refrain from appropriating opportunities and owe an obligation of good faith and fair dealing in winding up.

Although RUPA contains extensive new provisions on partnership breakups, much of the traditional analysis continues. Each partner has the power to dissociate at any time. ¹⁷⁸ The partnership agreement may provide for summary expulsions. ¹⁷⁹ Although RUPA continues to provide for expulsion pursuant to the partnership agreement, ¹⁸⁰ it also provides for expulsion by decree. ¹⁸¹ Unlike under the UPA, an expulsion causes a dissociation that does not in itself cause a dissolution, ¹⁸² and the new buyout rules apply to pay back the expelled partner.

RUPA's fiduciary duty and breakup rules interact to continue the rule that conduct that does not constitute an effective expulsion pursuant to agreement may nevertheless cause a rightful dissolution. ¹⁸³ In addition, despite considerable opposition, RUPA continues the rule that each partner has the right to liquidate the business of an at-will partnership. ¹⁸⁴ Absent a continuation agreement, a dissociating partner may call for liquidation of the partnership assets, satisfaction of all liabilities and distribution of any surplus

175. RUPA § 603(3). The duty of care also continues only with respect to these matters and events.

176. For example, it is not clear how to reconcile the statement that the duty to compete terminates with the statement that the duty to refrain from dealing as an adverse party continues.

177. See RUPA § 603 cmt. 2. "No change from current law is intended." *Id.*

178. See RUPA § 602(a). "A partner has the power to dissociate at any time, rightfully or wrongfully, by express will pursuant to Section 601(1)." *Id.*

179. See RUPA § 601 cmt. 4. "The expulsion can be with or without cause. As under existing law, the obligation of good faith under Section 404(d) does not require prior notice, specification of cause, or an opportunity to be heard." *Id.*

180. RUPA § 601(3). It also provides for expulsion by unanimous vote of the other partners in a very limited class of situations. RUPA § 601(4).

181. RUPA § 601(5). RUPA provides that the partnership agreement may not "vary the right of a court to expel a partner in the events specified in section 601(5)." RUPA § 103(b)(7).

182. Compare RUPA § 601, with RUPA § 801.

183. See RUPA §§ 202, 601, 602(b), 801, 802(a).

184. RUPA § 801(1).

in cash.¹⁸⁵ Furthermore, each non-wrongful dissolver has the right to participate in the control of the winding up.¹⁸⁶ These are the concepts Judge Cook did not explore under the UPA. There is no reason to believe he would have explored them under RUPA.

Despite the fact that RUPA does little to change basic policy, there are two aspects of RUPA that require special mention in *Cadwalader* situations. The first is RUPA's new rule that specifically authorizes the ratification of acts that would otherwise breach fiduciary duties. The second is RUPA's new definition of wrongful dissociation.

B. Amendment and Ratification

Given Judge Cook's language of moral indignation and the conclusion implicit in his punitive damage award that some very bad behavior took place, it is remarkable that he also said that the management committee could have accomplished its goal simply by amending the partnership agreement to permit expulsion: "There was a way for [Cadwalader] to address the problem of profitability and the presence of too many unproductive partners That was to present the problem to the partnership with a proposed amendment to the partnership agreement providing for the expulsion of partners."¹⁸⁷

The court's suggestion that the partnership agreement could have been amended¹⁸⁸ to permit expulsion raises two fundamental questions. The first is whether the partnership can ever add an expulsion provision over the objection of a partner to whom it will be applied. The second is whether interested partners may vote to ratify their own wrongs.

185. RUPA § 807(a).

186. RUPA § 803(a).

187. *Beasley v. Cadwalader, Wickersham & Taft*, No. CL-94-8646 "AJ," 1996 WL 438777 at *6 (Fla. Cir. Ct. July 23, 1996).

188. It is not clear why Judge Cook did not consider the 67-12 vote approving the reduction in the number of partners an amendment and expulsion. Was it because there was no express amendment of the partnership agreement? Was it because a 67-12 vote would have been insufficient for an amendment? Was it because the word "expulsion" was not used? The partners appear to have voted to approve the shut down of the Palm Beach office and the elimination of other partners. Would the actions with respect to Mr. Beasley have been approved by Judge Cook if the partners had voted instead for the following resolutions: (1) resolved that the closing of the Palm Beach office is the equivalent of an expulsion; (2) resolved that the partnership agreement is hereby amended to permit expulsion by the management committee or by a vote of a majority of partners; and (3) resolved that, in accordance with the amended partnership agreement, Palm Beach partners not assigned to other offices are hereby expelled? This appears to be the substance of what transpired without the use of the words "amendment" or "expulsion."

1. Subsequent Amendment to Authorize Expulsion

In general, partners cannot modify a partnership agreement without unanimous consent.¹⁸⁹ However, because this is a default rule rather than a mandatory rule,¹⁹⁰ a partnership agreement can authorize amendment by less than unanimous consent. There is authority for the proposition that a general provision for amendment includes amendments that authorize the expulsion of existing and objecting partners.¹⁹¹

In *Aztec Petroleum Corp. v. MHM Co.*,¹⁹² limited partners removed a general partner by amending the partnership agreement.¹⁹³ The original partnership agreement contained no provision for the removal of a general partner. However, it contained a general provision that authorized an extraordinary majority of the limited partners to amend the partnership agreement. The requisite number of limited partners voted to amend the partnership agreement to provide for the removal of the general partner and for the conversion of the removed partner's interest to that of a limited partner. After the partners approved the amendment, the limited partners removed the general partner.

The court held that the law does not require the general partner's "consent to its own replacement." The court sustained a summary judgment against the removed partner, stating that, as a matter of law, a general provision authorizing amendment includes an amendment adding a removal clause:

[N]either the partnership act nor the limited partnership act prohibit removal and substitution of a general partner in a limited partnership, even though the partnership agreement initially does not directly allow such action, if the partnership agreement provides a method for amendment and an amendment permitting substitution and removal of a general partner is adopted.¹⁹⁴

189. RUPA § 401(j).

190. RUPA § 103(a).

191. Cf. HILLMAN, *supra* note 23, § 5.3.2.

An expulsion by act of partners requires a preexisting agreement specifically authorizing the removal of partners. Absent such an agreement, an expulsion may not be accomplished without the unanimous consent of the partners; such consent would effectively be given for amending the partnership agreement to allow expulsions, a circumstance unlikely to occur since the target of the expulsion action would need to approve the amendment.

Id.

192. 703 S.W.2d 290 (Tex. App. 1985).

193. See *Aztec Petroleum Corp. v. MHM Co.*, 703 S.W.2d 290, 293 (Tex. App. 1985, no writ).

194. *Id.* at 293.

The court also rejected the argument that general partner status is such a "fundamental element of the agreement" that, as a matter of contract law, the partners cannot change it without unanimous consent. The court said that "any unanimity which may be required by contract law was met when all parties to the partnership agreement consented to be bound by amendments passed" by an extraordinary majority.¹⁹⁵

Aztec is distinguishable from *Cadwalader* in two important ways. First, *Aztec* involved a removal of a general partner by limited partners, who, unlike general partners, typically have no right to take part in the control of the partnership. Nor do they usually have the exit rights of a general partner. The only remedy many limited partners have is the right to select a general partner. Second, the partners demoted the general partner in *Aztec* to limited partner, rather than forcing him out of the partnership, and thus they did not extinguish his continuing economic interest in the business.

A court might view the addition of a clause authorizing complete expulsion as too fundamental a change to be made over the objection of a partner to whom it might apply.¹⁹⁶ On the other hand, particularly in partnerships with strong centralized decisionmaking, the addition of an expulsion clause under a general power to amend may be perfectly consistent with the relationship.¹⁹⁷

195. *Id.* at 294. "Having agreed to a contract which contained a mechanism for amendment upon approval of seventy percent of the partnership units, we conclude that [the removed general partner] cannot now create an exception for what it deems to be a fundamental element of the contract." *Id.*

196. See *McCallum v. Asbury*, 393 P.2d 774, 775-76 (Or. 1964). "Fundamental changes in a partnership agreement may not be made without the consent of all the parties. This is true even though the agreement may provide that it can be amended by majority vote." *Id.* On the other hand, *McCallum* held that it was permissible to amend the partnership agreement to create an executive committee and to give it management authority, subject to veto by a majority of partners within ten days: "We hold that these limitations upon the committee's powers kept the delegation well within the scope and intent of the original partnership agreement." *Id.* at 776; see also ALLAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP 6:48 (1996). Bromberg and Ribstein note:

Although it is clear that, despite the dictum in *McCallum*, even "fundamental" acts may be permitted over a partner's objection under an explicit provision in the partnership agreement, the *McCallum* dictum is significant as a warning that a court might strike down a majority-approved action that, although permitted by the express terms of the agreement, results in significant revision of a partner's rights. The court might rely on such facts as the weak bargaining position of the partner, the partner's lack of notice of the provision, significant damage suffered by the objecting partner, or an ulterior motive of the majority.

Id.

197. See *Day v. Sidley & Austin*, 394 F. Supp. 986, 992-93 (D.D.C. 1975), *aff'd sub nom.* *Day v. Avery*, 548 F.2d 1018 (D.C. Cir. 1976).

2. Ratification by Interested Partners

More fundamentally, it is unclear as a matter of policy why it would be appropriate to amend the partnership agreement to authorize the expulsion Judge Cook found so offensive. He treated the case as if it had involved the intentional appropriation of a partnership opportunity. On that assumption, the correctness of which I have questioned, it seems improper to permit the appropriating partners to vote to ratify their own conduct.

At first blush, RUPA provides specific statutory support for Judge Cook's dictum that the offending partners could have ratified the appropriation. Under RUPA, the duty to refrain from appropriating a partnership opportunity is part of the section 404(b) duty of loyalty. Section 103(b) provides that, although the partner may not "eliminate" the duty of loyalty, "all of the partners or a number or percentage specified in the partnership agreement may . . . ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty."¹⁹⁸ Does this mean that, under RUPA, Cadwalader's behavior would not be actionable because the "percentage specified in the partnership agreement [did] ratify a specific act [the constructive expulsion of Mr. Beasley] that otherwise would violate the duty of loyalty"?

The fundamental question presented by Judge Cook's view of the facts is whether partners who appropriate a partnership opportunity may vote to ratify the appropriation. Assume that Good, Bad and Ugly own and operate a three-person partnership to invest in real estate. Assume the partnership agreement states that all partnership decisions can be made by a two-thirds vote. Good discovers that Bad and Ugly have just purchased for their own account a property on which the partnership had submitted a bid. May Bad and Ugly vote, over Good's objection, to "ratify" their "specific act" which "otherwise would violate the duty of loyalty"?

There are several ways to explain the conclusion that Bad and Ugly may not ratify their own appropriation of a partnership opportunity. One way is to interpret the partnership agreement to deny relief to Bad and Ugly. One should interpret the partnership agreement in a manner consistent with the duty of loyalty and with the obligation of good faith and fair dealing. Unless there is a clear indication to the contrary, one should not interpret the partnership agreement to permit an appropriation of a partnership opportunity.¹⁹⁹

198. RUPA § 103(b)(3)(ii).

199. See generally *Singer v. Singer*, 634 P.2d 766 (Okla. Ct. App. 1981) (enforcing partnership agreement that said that partners could pursue opportunities as if partnership did not exist).

It is true that the drafters intended the ratification rule to embrace conduct that might be considered manifestly unreasonable. Although neither categorical waivers of the duty of loyalty nor performance standards for the duty of good faith and fair dealing may be "manifestly unreasonable,"²⁰⁰ RUPA's ratification rule has no "manifestly unreasonable" limitation. The Official Comments of RUPA make clear that the ratification rule "can . . . be used to validate conduct that might otherwise not satisfy the 'manifestly unreasonable' standard."²⁰¹ Nevertheless, the drafters did not intend the ratification rule to let Bad and Ugly do the ratifying.

The drafters did not intend the ratification rule to authorize partners to ratify their own wrongs. They intended the ratification rule to authorize innocent partners to ratify the wrongs of others. The Official Comments make this point clear by referring to consent by "the other partners"²⁰² and to consent by "the remaining partners."²⁰³ The essence of the ratification rule is a waiver of legal remedy by aggrieved partners:

Subsection (b)(3)(ii) is intended to clarify *the right of partners . . . to consent to a known past . . . violation of duty and to waive their legal remedies for redress of that violation*. This is intended to cover situations where the conduct in question is not specifically authorized by the partnership agreement.²⁰⁴

Therefore, the rule permits aggrieved or innocent partners to waive their claims, even if the offending conduct is manifestly unreasonable, provided there is full disclosure. This is consistent with general law enforcing informed waivers of the right to sue.

There is nothing in RUPA or in its history that insulates interested partners who attempt to ratify their own wrongs. Nor is there anything in RUPA that reverses UPA authority subjecting self-interested behavior to special scrutiny²⁰⁵ or that invalidates analogies to corporate law to the same effect.²⁰⁶

200. RUPA § 103(b)(3)(i).

201. RUPA § 103 cmt. 5.

202. RUPA § 404 cmt. 2. "As under UPA Section 21, *the other partners may also consent to a specific act or transaction that otherwise violates one of the rules.*" *Id.* (emphasis added).

203. RUPA § 103 cmt. 4. That comment states: "[T]he remaining partners can 'consent' to a particular conflicting interest transaction or other breach of duty, after the fact, provided there is full disclosure." *Id.* (emphasis added).

204. RUPA § 103 cmt. 5 (emphasis added).

205. See *Konover Dev. Corp. v. Zeller*, 635 A.2d 798, 810 (Conn. 1973). "Proof of a fiduciary relationship imposes a twofold burden on the fiduciary. First, the burden of [proving fair dealing] shifts to the fiduciary; and second, the standard of proof is clear and convincing evidence." *Id.*; see also *Starr v. Fordham*, 648 N.E.2d 1261 (Mass. 1995).

206. See *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971) (stating that, when parent corporation receives benefit from subsidiary to exclusion of, and detriment to, minority

One statutory basis for applying corporate analogies is section 104(a), which provides: "Unless displaced by particular provisions of this [Act], the principles of law and equity supplement this [Act]."²⁰⁷ The Official Comments state: "These supplementary principles encompass not only the law of agency and estoppel, . . . but all of the other principles listed in UCC Section 1-103; the law relating to capacity to contract, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other common law validating or invalidating causes, such as unconscionability."²⁰⁸ Although one could view "particular provisions" of RUPA as displacing some of the common law of fiduciary duties,²⁰⁹ none of RUPA's provisions authorize interested partners to ratify their own wrongs.

Another statutory basis for applying corporate analogies is the obligation of good faith and fair dealing. The obligation "applies whenever a partner discharges a duty or exercises a right under the partnership agreement or the Act,"²¹⁰ including the ratification right. The drafters intended that this broad contractual notion inform all partnership rights and duties, enriching rather than restricting partnership doctrine.

C. Wrongful Dissociation

Cadwalader's suggestion that dissociations are "wrongful" whenever they are unauthorized must be qualified in light of RUPA. "Wrongful dissociation" is a term of art under RUPA. Section 602(b) provides that a partner's dissociation is wrongful only if: (a) "in the case of a term partnership, there is a premature withdrawal;" or (b) "it is in breach of an express provision in the partnership agreement."²¹¹ If a dissociation is wrongful,

shareholders of subsidiary, burden is on parent to demonstrate intrinsic fairness). If the parent "usurped no business opportunity belonging to [the subsidiary]," the business judgment rule, rather than the intrinsic fairness requirement, applies. *Id.* at 722; *see also* *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 661 (Mass. 1976) (stating that stockholders in close corporation owe one another substantially same fiduciary duty as partners). Under *Wilkes*, if minority shareholders of a closely-held corporation allege "a breach of the strict good faith duty owed them by the majority, . . . [i]t must be asked whether the controlling group can demonstrate a legitimate business purpose for its action." *Id.* at 663. If the majority demonstrates a legitimate business purpose, the burden shifts to the minority to show that it could have been achieved with less harmful means.

207. RUPA § 104(a).

208. RUPA § 104 cmt.

209. *See* HILLMAN ET AL., *supra* note 5, at 37. "RUPA does attempt displacement of some common-law rules which coexisted with the Uniform Partnership Act, most notably in the area of the fiduciary duties of the partners *inter se*." *Id.*

210. RUPA § 404 cmt. 4.

211. RUPA § 602(b).

there are two basic consequences: (1) the wrongful dissociator is liable for damages caused by the wrongful dissociation,²¹² and (2) if the dissociation leads to a dissolution, which it does in the absence of a continuation agreement, the wrongful dissociator may not participate in the winding up of the partnership business.²¹³ Furthermore, in a term partnership, the surviving partnership need not pay the wrongful dissociator the buyout price until the term ends.²¹⁴

Despite the fact that language of wrongful dissociation might initially appear applicable to *Cadwalader*, there are two reasons it does not, even under Judge Cook's view of the case. First, *Cadwalader* apparently did not involve either a term partnership or a breach of an express provision of the partnership agreement. Under RUPA, neither breach of an implied provision nor breach of a statutory duty or obligation renders a dissociation wrongful. For example, a dissociation is not "wrongful" simply because it violates the implied obligation of good faith and fair dealing. Second, and more importantly, section 602(b) does not address the improper dissociation of another; rather, it addresses improper dissociation of oneself. Although the statutory language does not make the point obvious, one does not "wrongfully" dissociate another within the meaning of section 602.

V. Conclusion

RUPA's provisions convey the basic lesson of decades of case law that partners have enormous freedom to define their own relationship. Judge Cardozo's opinion in *Meinhard* is the typical American starting point for a study of case law on the fiduciary duty of partners. Unfortunately, it is all too often also the finishing line. Although the opinion sets a high moral tone, by its own terms one of "uncompromising rigidity," *Meinhard* says nothing about the flexibility partners have to define their own relationships. It addresses only the duty to share information about a partnership opportunity in the absence of an agreement defining or restricting the duty.

RUPA codifies the lessons of decades of decisions after *Meinhard*. Subsequent case law contains at least four separate principles that combine to give partners great flexibility in setting their own rules: (1) partners are free to restrict the scope of their business relationship; (2) the fiduciary

212. See RUPA § 602(c). RUPA provides: "A partner who wrongfully dissociates is liable to the partnership and to the other partners for damages caused by the dissociation. The liability is in addition to any other obligation of the partner to the partnership or to the other partners." *Id.*

213. See RUPA § 803 (providing that partner "who has not wrongfully dissociated" may participate in winding up business).

214. RUPA § 701(h).

duties of partners do not require them to be selfless; (3) partners may agree to limit their fiduciary duties to just short of the vanishing point; and (4) in an at-will partnership, partners have both the power and the right to end the relationship at any time, even for a selfish reason, provided they do not appropriate an asset or violate the obligation of good faith and fair dealing.

RUPA does not change the basic analysis of situations like *Cadwalader*. An enormous edifice of case law has been constructed on and around the use of the word "fiduciary" in the title to UPA section 21. Courts and commentators are likely to move that edifice to the site of RUPA section 404, placing two corners on the duties classified as fiduciary and two corners on the obligation of good faith and fair dealing.

Under RUPA, the basic measure of partner conduct remains the expectation of the partners in the relationship they have created. In particular, their expectations with respect to dissociation are of supreme importance. If those expectations are not clear, RUPA controls. Although RUPA contains a far more detailed statement of the rights of dissociating partners than the UPA, the fundamental dissociation analysis continues. Partners in firms without continuation agreements may dissolve at will, but they must account to their partners in the process of winding up. It is this analysis that was slighted in *Cadwalader*, both by the dominant partners and by the court.

