THE BARGAIN IN THE FIRM: PARTNERSHIP LAW, CORPORATE LAW, AND PRIVATE ORDERING WITHIN CLOSELY-HELD BUSINESS ASSOCIATIONS†

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Partnership law and corporate law are two distinct bodies of legal scholarship. Over time, each of these separate bodies of law has adopted features of the other. The author examines the effects that partnership law has had on corporate law and the reciprocal effects that corporate law has had on partnership law. He highlights hybrid entities such as the close corporation and the centrally managed partnership. He also explores the different bargains that are made between partners in contrast to the bargains made by corporate shareholders.

I. INTRODUCTION

Partnership law offers a comprehensive and coherent alternative to corporate law as a governing framework for firms engaged in commercial ventures. Although the two bodies of law have much in common, historically they have differed sharply on the role of the contract and private ordering in structuring the firm. Partnership law encourages private ordering through bargaining by providing a set of statutory default norms that, with only a few exceptions, yield to agreements negotiated by partners. Corporate law, in contrast, historically has provided a mandatory framework for firm structure which is highly resistant to shareholders' attempts to define their relationships through bargaining.

Proponents of private ordering within firms prefer the freedoms of partnership law to the mandates of corporate law, and over time they have enjoyed some success in extending the bargaining model from partnership law to corporate law. In this sense, it may be said that partnership law has influenced the shape of corporate law. Still, some caution is

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necessary in describing the degree of that influence or in suggesting that corporate law is moving closer to partnership law. There is first the problem of oversimplification when evaluating bodies of law as rich and diverse as partnership law and corporate law. For example, partnership law itself departs from contractarian principles in important respects that serve to undermine its image as law predicated on contractually established relationships.[1] Moreover, the influence equation is reciprocal, and recent reforms in partnership law reflect the influence of corporate law in lessening the role of the contract in defining the relationship among a firm's participants.[2]

There exists an even more fundamental challenge to comparing partnership law with corporate law in defining what we mean by "corporate law" and, for that matter, "partnership law." Especially in the role assigned the contract in structuring relations within the firm, some corporate law so closely resembles partnership law that in many important respects distinctions between the two have disappeared. The key to this statement lies in the adjective "some," which for this purpose delineates the portion of corporate law dealing with closely-held firms.

The law of the public entity dominates corporate law scholarship. This corporate law struggles to define and protect the interests of a large, amorphous, and essentially passive group of shareholders who typically hold diversified portfolios and whose willingness and ability to focus attention on any single investment in that portfolio is limited. Aggrieved shareholders of publicly-held firms normally have an exit option available through the liquidity provided by organized securities markets.

Another corporate law addresses the closely-held firms that at one time or another elected corporate status. Here, the problem lies in the exercise of control by one group of shareholders to the disadvantage of another group under circumstances in which disadvantaged shareholders, unlike their counterparts in publicly-held firms, typically do not have an easy exit option. This is the corporate law under which private ordering through bargaining among shareholders has achieved slow but steady gains. It is also the corporate law largely ignored by contemporary legal scholars.

The two corporate laws, and the concerns addressed by each, are quite distinct.[3] Recognizing the distinction is critical in assessing the content as well as the evolution of "corporate law." It is also a premise underlying this article, which considers private ordering in closely-held

1. Most importantly, contractual attempts to modify statutory standards of conduct are subject to some limitations. *See infra* text accompanying notes 52–56.

2. For example, corporate law has inspired statutory reforms promoting the "entity" status of partnerships, with the consequence that partnership stability in the face of partner withdrawals has been enhanced. *See infra* text accompanying notes 68–71.

3. For early recognition of this point, see Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 259 (1967).

firms and the degree to which partnership law and corporate law have influenced each other.

II. A PRELIMINARY NOTE ON THE VOCABULARY OF PRIVATE ORDERING

Given the importance of language in law, this discussion begins with a few brief comments on the terminology commonly associated with private ordering.

Private ordering describes the structuring and maintenance of a relationship by participants (partners or shareholders). For present purposes, it is conduct that is allowed and even facilitated by the absence of statutory mandates limiting this action. Although private ordering commonly is manifested through bargaining among the participants, bargaining is not the sole means by which private ordering may be accomplished.

An *agreement* is a means by which private ordering typically is implemented, but it is also a somewhat more nuanced term than many discussions of private ordering acknowledge.[4] To the economist, the term "agreement" usually references a voluntary relationship with expectations of mutual and reciprocal benefits, without regard to whether the expectations are legally enforceable. To the lawyer, enforceability is the essence of an agreement, which, from this perspective, is a term that is interchangeable with contract. For the lawyer, the agreement that underlies a partnership may be a formal document entitled "Partnership Agreement," while the economist may find within the same partnership a myriad of understandings (or agreements) not reflected in the formal document.

Even the critical term "firm" displays nuances dependent on the context in which it is used. To the economist, the firm may be the aggregate of the relationships offering inputs organized under the authority of an entrepreneur.[5] To the lawyer, the firm may be the associational vehicle that is the aggregate or the extension of its owners, whether they are partners or shareholders.[6] To the participants in the enterprise, the firm may be a community of individuals bonded in a desire for occupational independence and motivated, at least in part, by concerns that neither the economist nor the lawyer can fully appreciate.[7]

4. This point is powerfully made by my colleague Tom Joo, who distinguishes the lawyer's contract (legally enforceable promises) from the economist's contract (voluntary agreement characterized by reciprocal expectations and behavior). Thomas W. Joo, *Contract, Property, and the Role of Metaphor in Corporations Law*, 35 U.C. DAVIS L. REV. 779, 789–91 (2002).

5. *See, e.g.*, R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 387–88 (1937).

6. The lawyer's first and (sometimes) last involvement may be with the respect to the organizational formalities associated with establishing a firm.

7. For a discussion of the firm and the quest for occupational dignity, see Robert W. Hillman, *Power Shared and Power Denied: A Look at Participatory Rights in the Management of General Partnerships*, 1984 U. ILL. L. REV. 865, 887–94.

Regardless of who is using the term and the meaning assigned to it, the nature of a firm will vary depending upon the breadth of its ownership. Closely-held firms have unique characteristics and needs, and, as the next section will discuss, the development of corporate law and theory over the last century shows a gradual but steady evolution of a unique law applicable to the "incorporated partnership."

III. PARTNERSHIP LAW AS A MODEL FOR CORPORATE LAW: A VERY BRIEF HISTORICAL PERSPECTIVE ON THE "INCORPORATED PARTNERSHIP"

A first and necessary step in the acceptance of contractarian principles in corporate law was the recognition of fundamental differences between publicly-held and closely-held firms. With this distinction made, the corporate law of close corporations looked to the partnership model to devise new approaches to the special circumstances of shareholders in closely-held firms. Placing this development in some historical context illustrates how the contractarian debates and issues of today were anticipated, and sometimes addressed in depth, by scholars and jurists of previous generations.

At least as early as 1912, when a New York decision spoke of "private enterprises [that] . . . . were little more . . . than chartered partnerships,"[8] courts noted a distinction between closely-held corporations and

8. Ripin v. United States Woven Label Co., 98 N.E. 855, 856 (1912). The point made in the case seems obvious today but was a bold statement at the time. Consider, for example, the reasoning of the Wisconsin Supreme Court in invalidating a bylaw that required unanimous shareholder consent for a stock transfer:

> It is again very plausibly argued . . . that what might be against public policy in a public or *quasi* public corporation, would not be in a strictly private corporation, and that the latter corporation was in substance only an incorporated partnership. We cannot give countenance to any such distinction. The policy of incorporating a strictly private business, with a limited liability of the stockholders towards their creditors, is at least questionable. But when a private business or a partnership has become incorporated under the general law, and greatly favored by privileges and franchises and by restricted liability, there is no reason for making any distinction between such a corporation and others, and our statutes make none. The corporators have secured the advantages of a corporation, and they should be governed by all the other incidents of a corporation. Why not? They cannot be a corporation, and still remain, in respect to the same business, a copartnership. The one must completely displace the other.

In re Klaus, 29 N.W. 582, 584 (Wis. 1886).

For a different perspective considering ways to achieve corporate advantages without incorporating, see EDWARD H. WARREN, CORPORATE ADVANTAGES WITHOUT INCORPORATION (1929). Professor Warren was an early contractarian:

> Thus we shall inquire to what extent two or more human beings who join together to further their financial interests can, without being regarded as members of a legal unit, nevertheless attain by force of agreements advantages approximating the corporate advantages. This is a field in which the ingenuity of counsel has long been active, and the reader who is not acquainted with the cases will probably be surprised to find how close an approximation to the corporate advantages can be attained by agreements—*provided,* that the courts enforce the agreements. . . . In the so-called Massachusetts trust, we shall see that a very close approximation has been attained . . . . But then the question arises as to how far it is consistent with public policy that such agreements should be enforced, . . .particularly since the law on the matter is still unsettled in most states.

Id. at 13–14.

larger firms. It was not until 1936, however, that a significant court decision actually molded corporate law to the special circumstances of a closely-held firm. In *Clark v. Dodge*,[9] the New York Court of Appeals allowed enforcement of a broad shareholder agreement that departed from statutory norms on fundamental matters such as voting for the election of directors, appointment of an officer, and guarantees of compensation. Not surprisingly, however, the path of reform was not linear, and within a decade the same court was retracing its earlier contractarianism steps in a decision seemingly restoring a unitary view of corporate law applicable to all incorporated firms.[10] The push and pull between advocates of a unitary corporate law and proponents of special rules for close corporations continued for a time and was resolved with an important concession to the latter that was embodied in a New York statute allowing some departures from statutory norms (especially in the area of supermajority voting and quorum requirements) for close corporations.[11]

And what of the reaction of scholars to this important development within corporate law? The new statute was embraced by Carlos Israels in an influential article published in the *Cornell Law Quarterly*.[12] The Israels article formed part of a small but influential body of scholarship appearing in the 1940s urging development of special legal principles for close corporations on the theory that these firms were simply "incorporated partnerships" for which the mandatory rules and structures of corporate law were ill suited.[13] This was an era in which commentary often followed, rather than anticipated, developments in the law, and the commentary on close corporations was no exception—courts led the way.

By 1950, a contractarian movement in corporate law grounded in partnership law had found its legs, not by virtue of the emergence of a compelling new theory advanced by scholars, but as a product of the perception of law makers and practitioners that the corporate theory of the past did not meet the needs of the 1950s.[14] On the whole, legal scholarship endorsed corporate law developments that brought the legal structure for close corporations closer to that of partnerships. George Hornstein, writing in the 1950 volume of the *Yale Law Journal*, revealed his

9. 199 N.E. 641, 642–43 (N.Y. 1936).

10. *See* Benintendi v. Kenton Hotel, 60 N.E.2d 829, 831 (N.Y. 1945) (refusing to enforce an agreement calling for supermajority voting requirements at the shareholder and director levels and noting that such an arrangement is "obnoxious" to the statutory scheme for corporate governance).

11. For a discussion of the New York statute and the influence of Illinois and Delaware corporation laws on this statute, see Carlos D. Israels, *The Close Corporation and the Law*, 33 CORNELL L.Q. 488, 502 (1948).

12. *Id*; *see also* Norman Winer, *Proposing a New York "Close Corporation Law*," 28 CORNELL L.Q. 313 (1943).

13. Originally, the term "incorporated partnership" was used to describe corporations that originally had been partnerships. *See, e.g.*, Riley v. Loma Vista Ranch Co., 82 P. 686, 687–88 (Cal. Ct. App. 1905).

14. The movement coincided with an increase in the number of small corporations that may have been prompted by the implementation of high personal income tax rates. *See* Manne, *supra* note 3, at 277.

contractarian leanings by referencing the partnership yearnings of participants in closely-held corporations.[15] He observed that, "There is no reason why mature men should not be able to adapt the statutory form to the structure they want, so long as they do not endanger other stockholders, creditors, or the public, or violate a clearly mandatory provision of the corporation laws."[16] Particularly telling observations on the state of American corporate law were subsequently offered by a British academic who, after noting that English corporation law is essentially contractual, observed: "To an Englishman, it seems strange that corporate codes, such as that of Delaware, which are notoriously lax in failing to provide important safeguards against abuses, should nevertheless be strict in matters which seem to us to be essentially for the parties themselves to settle."[17]

Why would English and American law depart so significantly on the basic issue of the role of private ordering in firms? Dean F. Hodge O'Neal, who was the most influential of all scholars in making the case for recognizing the special needs of participants in close corporations, provided at least a partial answer when he observed:

> Judges and legislators, no less than other men, are creatures of their culture: its ideas are their ideas, its methods their methods, its limitations their limitations. A great number of our present judges and legislators are part of the legal generation which grew up in an atmosphere of corporate theory pervaded with the "concession theory" of corporate existence, under which a corporation is viewed as an artificial, fictitious being, and a corporate charter as a grant from a sovereign giving "life" to a new legal entity. Small wonder it is that such a generation is slow to approve unorthodox arrangement among shareholders which imply that a corporation is simply a group of businessmen voluntarily associating together, with freedom within broad bounds to determine by contract their relations among themselves.[18]

These comments on judges and legislators as products of their culture can certainly be extended to lawyers. Perceptions formed early in a law career may prove lasting, and the seeds of future reform in law are often planted in law school classrooms. The status of contractarian thinking in law school at any period of time may be measured by the ma-

15. George D. Hornstein, *Stockholders' Agreements in the Closely Held Corporation*, 59 YALE L.J. 1040, 1040 (1950) (noting stockholders desire an "incorporated partnership").

16. *Id*. at 1056.

17. L. C. B. Gower, *Some Contrasts Between British and American Corporation Law*, 69 HARV. L. REV. 1369, 1376–77 (1956).

18. F. Hodge O'Neal, *Oppugnancy and Oppression in Close Corporations: Remedies in America and in Britain*, 1 B.C. INDUS. & COM. L. REV. 1, 5 (1959). Dean O'Neal's early work on close corporations was funded by a grant from the Small Business Administration and was published as the first text focusing on the special circumstances of shareholders in close corporations. *See* F. HODGE O'NEAL, EXPULSION OR OPPRESSION OF BUSINESS ASSOCIATES: "SQUEEZE-OUTS" IN SMALL ENTERPRISES (1961). He borrowed heavily from the partnership model in his discussions of close corporations.

terial then offered in casebooks and texts. In the 1950s, one of the more important of such works was a 1951 casebook by E. Merrick Dodd and Ralph Baker, which excerpted a number of cases involving close corporations, including the aforementioned *Clark v. Dodge*, but failed to offer systematic commentary on the emergence of an important trend in corporate law.[19] In contrast, the successor edition to this casebook, authored by Ralph Baker and William Cary and published in 1959, included an entire section on close corporations brimming with commentary appropriate to the trends that now were clearly evident.[20] Appropriately enough, the section was entitled, "The Special Problems of the Close Corporation: Organization and Operation of the Firm to Achieve Partnership Advantages."[21] At least in law schools, the 1950s seemed to mark a significant change in how closely-held firms were viewed.

By the 1960s, the reform movement in corporate law had gained considerable momentum. It was helped greatly by the 1965 landmark decision of the Illinois Supreme Court in *Galler v. Galler*,[22] which relied heavily on academic contractarian thinking in endorsing the use of shareholder agreements to structure relationships among participants. Ten years later, the Massachusetts Supreme Court in *Donahue v. Rodd Electrotype Company of New England*[23] emphasized the "fundamental resemblance of the close corporation to the partnership"[24] as its reason for applying what it regarded as partnership law's stricter fiduciary standards to actions of a controlling shareholder in a close corporation. *Galler* and *Donahue* are important decisions in their validation of the gradual but steady movement within corporate law, emphasizing the unique qualities and needs of closely-held firms.

From the beginning, the reforms of corporate law affecting close corporations have emphasized the distinctiveness and "uncorporate" like character of these firms. Although close corporations outnumber their publicly-held counterparts by a very considerable margin, we do not hear calls to redefine corporate law to reflect the influence of closely-held

19. *See* E. MERRICK DODD & RALPH J. BAKER, CASES AND MATERIALS ON CORPORATIONS 273–94 (1951). An especially lucid and perceptive casebook by Jack Latty of the Duke Law School, also published in 1951, had no coverage of developments affecting close corporations. *See* ELVIN R. LATTY, INTRODUCTION TO BUSINESS ASSOCIATIONS (1951). Yet the 1961 text on close corporations authored by O'Neal, see *supra* note 18, was the implementation of a project originally conceived in the late 1950's by then-Dean Latty. This provides further support for the view that the 1950s was a critical period in the development of academic views of the close corporation.

20. *See* RALPH J. BAKER & WILLIAM L. CARY, CASES AND MATERIALS ON CORPORATIONS 249–329 (1959).

21. Although most of the material devoted to close corporations was assigned a separate section in the text, some minor treatment of close corporations was interspersed with materials focusing on publicly-held firms. *See, e.g.*, *id*. at 330–51 (classification of shares and voting trusts); *id*. at 472–79 (executive compensation).

22. 203 N.E.2d 577 (Ill. 1965). Somewhat surprisingly, the court did not highlight partnership law as its inspiration.

23. 328 N.E.2d 505 (Mass. 1975).

24. *Id.* at 515.

firms.[25] To the contrary, proponents of reform from the beginning have sought to free close corporations from the formality and rigidity of corporate law. Their reforms are premised on the similarity of close corporations with partnerships, an insight concisely conveyed with the phrase "incorporated partnership."

Although short, the above history should be adequate to document the important influence of partnership law on corporate law, or to be more precise, the portion of corporate law dealing with closely-held incorporated firms. The partnership analogy has appeal, and the phrase "incorporated partnership" has found its way into the vocabulary of corporate law because it aptly conveys the view that close corporations have more in common with partnerships than corporations. This, in turn, has facilitated the extension of the bargaining underpinnings of partnership law to corporate law, if the law of close corporations is properly regarded as corporate law.

IV. RESTATING UNSTATED ASSUMPTIONS: IS IT REALLY CORPORATE LAW?

The above discussion illustrates that for nearly a century partnership law has influenced the shape of corporate law. Alternatively, the above discussion fails to establish that partnership has had anything more than a tangential effect on the development of corporate law. Which of these propositions is the more appealing is a function of how one views corporate law.

Legal academics have long had a fascination with publicly-held firms. Corporate law literature is dominated by writing on issues of corporate governance and market regulation as those issues affect firms with large numbers of owners. At its 2004 annual meeting, the Business Associations section of the Association of American Law Schools (AALS) directed its attention exclusively to "Corporate Governance after Enron," a topic that is consistent with the focus of contemporary scholarship. Academics more interested in issues of the closely-held firm presumably sought offerings outside the Business Associations Section. They may or may not have found what they were seeking in the program offered by the Section of Agency, Partnership, and Unincorporated Associations, which focused on nursing home agreements and the uses and abuses of financial powers of attorney.[26]

25. For a counterargument that corporate law is evolving with an emphasis on close corporations, see Manne, *supra* note 3, at 284 (concluding "[o]ur general corporation laws seem to be in the process of becoming general close corporation laws with only incidental relevance to large companies.").

26. Perhaps without design, the programs of the Business Association Section and the Section of Agency, Partnership and Unincorporated Associations were scheduled at the same hour, making it impossible (or nearly so) for an interested academic to attend both.

The AALS program reflects the present preferences of the majority of academics who identify themselves as corporate law scholars. From their perspective, corporate law is really the law of the megafirm—characterized by passive owners who hold diversified portfolios and whose risk is defined as the amount invested in each stock within the portfolio.[27] For publicly-held firms, corporate law's efforts are directed to issues of governance and management accountability.[28] In contrast, partnerships and close corporations may have a small enough number of owners that private ordering through contract is a realistic means of structuring the underlying business relationships. The participants' investments in their firms often are substantial, nondiversified, and illiquid. The exit option provided by securities markets serving shareholders in publicly-held firms is not available. Consequently, disgruntled shareholders in close corporations must suffer unhappy circumstances for extended periods of time. Moreover, these owners may invest their energy as well as their money, and a quick glance at a balance sheet assessing capital contributions provides only a small measure of what they have actually invested in their firms.

The developments affecting close corporations are a change only at the margins of corporate law, if they are to be regarded within the corporate sphere at all. One way to rationalize these developments is as the emergence of a form of associational law that reaches all closely-held firms, whether or not they are incorporated. So viewed, the developments described above ultimately may lead to a unified legal structure for closely-held firms.[29] Although such a result has some appeal, it incorrectly assumes a uniformity across closely-held firms. This point is more fully developed in the next section.

V. WHAT IS THE "TYPICAL" PARTNERSHIP?

Much of our thinking about partnerships and the shape of partnership law itself is grounded on a view of partnerships as firms populated by a small number of owners who interact with each other in the management of their firms. The smallness of their number allows partners to structure their relationships through bargaining. The premise of an egalitarian model of partnerships structured through private ordering underlies the reasoning in decisions and commentary seeking to distance "incorporated partnerships" from the statutory mandates of corporate law.

27. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1425–26 (1989) (describing the corporation in this manner).

28. *See, e.g.*, STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 207 (2002) (succinctly making the point that "[e]stablishing the proper mix of discretion and accountability . . . emerges as the central corporate governance question.").

29. For a cogent argument that this should occur, see Harry J. Haynsworth, *The Need for a Unified Small Business Structure*, 33 BUS. LAW. 849 (1978).

When partners fail to exercise their bargaining option, the default norms of partnership law readily provide a standard form agreement calling for equal rights in the participation of management and equal shares in the profits of the partnership.[30] The governance structure outlined in the statute calls for an around the table type of gathering for decision making and effectively provides any partner with a veto power over actions not in the ordinary course of business.[31] By enabling a single partner to block important actions, partnership law creates a dynamic that places a premium on the achievement of a consensus over the assembling of a control coalition.

A view of the firm as a community of equals is consistent with the joint and several liability of partners for claims against the firm. The potential for liability is a major reason why partnerships incorporate. For partners not pursuing the corporate option for their firms, the liability risk may be managed by participating in firm governance and ongoing monitoring of the activities of colleagues. The monitoring, in turn, is facilitated by the significant rights partners have to obtain information about their firms.[32] The governance structure, equal sharing in income as well as liabilities, and access to information are consistent with, and supportive of, the egalitarian model of partnerships.

Many firms that are not publicly-held firms fit the egalitarian model, but a growing number of firms do not. Professional service firms are the prime example of firms that defy the traditional distinction between closely-held and publicly-held firms. Law firms with partners numbering in the hundreds are becoming increasingly common. The largest accounting firm has nearly 3000 partners, and the smallest of the "Big Four" accounting firms has 1500 partners.[33] Even when the ownership base of such firms may be large enough to support a market for the equity interests, contractual and regulatory restrictions generally operate to limit or eliminate altogether the transferring of such interests in professional service firms.[34]

Between the well-populated extremes of firms with only a handful of owners and firms with owners numbering in the thousands are firms that fit neither the closely-held nor publicly-held classifications. These are the firms with a sufficient number of owners to require centralized

30. *See* UNIF. P'SHIP ACT § 401 (1997), 6 U.L.A. (pt. I) 275 (2001) [hereinafter RUPA]; UNIFORM P'SHIP ACT § 18 (1914), 6 U.L.A. (pt. I) 1 (2001) [hereinafter UPA].

31. *See, e.g.*, RUPA § 401(j) (stating that differences as to matters in the ordinary course of business are to be resolved by a majority of the partners; other matters require the consent of all partners); UPA § 18(h) (same).

32. *See* RUPA § 403 (providing partners with significant (and to a large extent nonwaivable) access to books and records); UPA § 19 (same).

33. For data on firm size, see Robert W. Hillman, *Organizational Choices Of Professional Service Firms: An Empirical Study*, 58 BUS. LAW. 1387 (2003).

34. *See generally* ROBERT W. HILLMAN, HILLMAN ON LAWYER MOBILITY § 6.8 (2d ed. 1998 & Supp. 2004) [hereinafter LAWYER MOBILITY] (discussing the law and ethics of partner withdrawals and law firm breakups).

management, which itself is a departure from the basic partnership norm of equal participation in management, but not so large as to support the development of mechanisms for transferring ownership interests.

All of this means that the egalitarian model reflected in partnership law and the associated commentary aptly describes some, but not all, contemporary partnerships. The egalitarian model likely reflected the universe of unincorporated firms that existed early in the last century, but a growing number of partnerships simply have outgrown the model. This has important implications for private ordering. Bargaining options are inversely related to the size of a firm.[35] As the number of partners increases, and turnover within the firm grows, bargaining may be little more than a fiction intended to rationalize a firm's structure.[36] This point is more fully developed in the discussion below.

VI. STATIC VERSUS DYNAMIC BARGAINING: WHAT IS THE PARTNERSHIP AGREEMENT?

Partners often reduce their understandings to writing in a partnership agreement. Subsequently, they turn to that agreement to determine their respective rights and duties. When partners fail to have written agreements, as occurs frequently, they may assert the existence of oral agreements. Lacking either a written or oral agreement, partners may seek to establish implied understandings sufficient to constitute agreements covering the points at issue.[37]

Whether express or implied, these types of agreements involve real or imagined incidents of discrete bargaining, typically, but not necessarily, occurring at the inception of the relationship among the partners.[38] They are snapshots reflecting the relative positions of the partners at one moment in time.

The snapshot agreement may be the first and last agreement, as lawyers use the term, among the partners. In such a case, a bargain once concluded is simply not reopened. Rebargaining may not occur because the snapshot agreement adequately anticipates and addresses ongoing partner concerns,[39] or because the partners are unable to reach a consen-

35. For a discussion of the reasons in the growth in the size of firms in law, accounting, and investment banking, see Randall S. Thomas et al., *Megafirms*, 80 N.C. L. REV. 115 (2001).

36. *Id.*

37. For example, a partner may point to a course of conduct supporting an implied agreement as to the duration of the partnership in the hope that withdrawal of another partner will be seen as premature and in breach of the agreement. For a discussion of implied terms in partnership agreements, see Robert W. Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations*, 67 MINN. L. REV. 1 (1982).

38. RUPA defines "partnership agreement" broadly to include written, oral, and implied agreements. *See* RUPA § 101(7).

39. For example, in a partnership for the operation and management of real estate, if partner contributions to the venture are understood and identified at the inception, there may be neither the need nor the desire to adjust the agreement during the life of the partnership.

sus on how the agreement should be modified, or because partners want to avoid perceptions of reneging if issues addressed in the agreement are reopened, or because partners are uneasy over the likely outcome of any rebargaining. Whatever the reason, a partnership operating under a discrete agreement that reflects the bargain that has been struck at the formation of the relationship fits very comfortably within the framework of a partnership law that places great emphasis on the partnership agreement itself.

Many partnerships defy the traditional static concept of the partnership agreement and experience periodic or ongoing rebargaining. The original agreement of a long-standing partnership may be more suitable as a decorative display than as a governing document of a firm whose membership may be changing constantly. For example, the website of one prominent firm, which claims to be the oldest law firm west of the Mississippi, proudly points to its establishment through an 1820 agreement that now "hangs on the wall of the firm's boardroom as a reminder of the long and storied history of the firm."[40] For firms old and young, the relative contributions of partners may change after the original bargain is struck, prompting partners believing their contributions are now undervalued to renegotiate the terms of the original agreement. Alternatively, partners simply may assume bargaining is an ongoing process that facilitates continuous readjustments based in whole or in part on current contributions to the enterprises.

Rebargaining within firms may occur with a subtlety—masking the nature of what is happening. The activity may result in fundamental changes in partnership governance or the way the firm allocates income without necessitating any change in the firm's formal partnership agreement. Although any departure from statutory default norms must be grounded in an agreement among the partners, there are many layers of partnership agreements. The most visible layer is the formal agreement. Beneath this layer is the adjustment to the original agreement that is the ongoing activity and process of rebargaining. This is especially true for large firms with centralized management and a significant turnover of partners, where rebargaining and its results may largely be unknown to partners not involved in these activities. The formal partnership agreement remains unaltered even in the face of ongoing bargaining significantly altering the relative economic interests of the partners in the firm.

Recognition of the dynamic nature of bargaining in some firms is important in understanding the role of agreements in private ordering. The bargain struck may or may not be reflected in the document we call a partnership agreement, and even when it is captured in such a document the consensus crafted today may not remain in place tomorrow.

40. *See* Rose Law Firm, *Our History*, http://www.roselawfirm.com/about/history_01.asp (last visited Aug. 17, 2004).

VII. FIRM SIZE AND PRIVATE ORDERING

Many contemporary firms bear little resemblance to the egalitarian model of partnerships. One obvious point of departure is size, as discussed above. As partners grow in number, governance necessarily becomes centralized, often through a committee of partners elected periodically. Although centralized management initially may be grounded in consent expressed in a partnership agreement, and in this sense is a product of bargaining, the necessity for its existence is a negation of the egalitarian model of the partnership emphasizing substantial participation in governance by all partners.[41] In this sense, firms have outgrown the law under which they operate.

Partners in very large professional service partnerships, such as law and accounting firms, may more closely resemble employees than co-owners of their firms. In some cases, this is because they actually are employees and not partners. The hierarchical character of such partnerships is carried to an extreme when they include a class (or multiple classes) of partners without any of the rights typically associated with owners:

> The handsomely designed announcement circulated by the firm will no doubt present you to the world as a "partner," without caveat or qualification. However, within the law firm itself, there may be great differences between your status and that of other partners. Indeed, your partnership may have an entirely different meaning than those of classmates who have just been made partners at other law firms, or even in the same firm.[42]

Typically called nonequity or salaried partners, these individuals are presented to a firm's constituencies as partners even though they may have neither the participation in control rights nor the income sharing opportunities that are fundamental attributes of traditional partner status. Little data exists on how many such partners actually occupy this rank, although it appears that, at least within law firms, their numbers are large and growing due in part to the growing number of true partners who have been demoted through "de-equitization."[43] From the private ordering perspective, nonequity partners represent a group of partners for which the bargaining model underlying partnership law simply has no relevance.

41. For an example of a large firm's agreement, see *Day v. Sidley & Austin*, 394 F. Supp. 986 (D.D.C. 1975) (entrusting the executive committee with all questions of firm policy and allowing an amendment of the partnership agreement on the vote of a majority of the partners).

42. Geri S. Krauss, *Partnership Roles Vary Widely From Firm to Firm*, N.Y. L.J. Jan. 27, 2003, at 57, *available at* http://www.nylawyer.com/news/03/01/012703e.html (last visited Aug. 24, 2004).

43. *See, e.g.*, Jeff Blumenthal, *On the Distasteful Medicine of De-Equitization*, THE LEGAL INTELLIGENCER, Dec. 3, 2002, at 1; Renee Deger, *Some Partners Lose Equity at McCutchen*, THE RECORDER, Sept. 21, 2001 at 1, *available at* http://www.law.com/regionals/ca/stories/edt0921d.shtml (last visited Aug. 24, 2004).

Even when partners of large firms truly have the functional status of partners, they may have comparatively little influence over the management of their firms, if for no other reason than the size of their firms diminishes their voices. Indeed, partners often may be removed from their firms on the basis of nothing more than the direction of a management committee.[44] At first glance, such a removal, which partnership law labels an "expulsion" and in other contexts would be described as a "firing" or "sacking," contradicts a partner's status as co-owner of the firm. The response, of course, is that the removal may only occur if authorized by the partnership agreement and, accordingly, is simply an implementation of the bargain previously struck by the targeted partner.[45]

This rationale based on an underlying agreement is critical to explaining and validating the actions of a large firm. Through creative application of concepts such as consent, ratification, delegation, and so forth, all actions of the managers of a large firm may be brought under the umbrella of the partnership agreement.[46] By extension of this reasoning, any partner's complaint about the actions may be nullified on the ground that the partner "got what she bargained for."[47]

The problem with this reasoning, however, lies in the assumption that the private ordering reflected in the partnership agreement is an exercise in which the affected partner has participated. As firm size grows, the prospect of bargaining the agreement with each group of newly admitted partners becomes more fiction than fact. To the contrary, new partners typically must accept the existing partnership agreement without alteration if they are to enjoy the benefits of admission to the partnership. Indeed, anecdotal evidence suggests that in many large partnerships (especially professional service firms) most partners are unaware of the contents of their firms' partnerships agreements.

One way to accommodate large firms within a bargaining model of governance is through the periodic authorizations and ratifications that occur when partners vote on managers and other major items affecting the partnership. Partners may, for example, vote once a year on the composition of the management committee and major issues affecting their firm. This rationalization rests on a critical presumption that con-

44. For a discussion on law partner expulsions, see LAWYER MOBILITY, *supra* note 34, at ch. 5; Larry E. Ribstein, *Law Partner Expulsion*, 55 BUS. LAW. 845 (2000); Allan W. Vestal, *Law Partner Expulsions*, 55 WASH. & LEE L. REV. 1083 (1998); Donald J. Weidner, Cadwalader, *RUPA and Fiduciary Duty*, 54 WASH. & LEE L. REV. 877 (1997).

45. *See* RUPA § 601(3) ("[E]xpulsion pursuant to the partnership agreement" is an event causing dissociation.); UPA § 31(1)(d) (finding dissolution caused by an expulsion of a partner "bona fide" in accordance with such a power conferred by the agreement).

46. *See, e.g.*, *Day*, 394 F. Supp. at 991–92 ("Having read and signed the [Partnership Agreement] which *implicitly authorized* the Executive Committee to create, control or eliminate firm committees, plaintiff 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.") (emphasis added).

47. *Cf.* Roan v. Keck, Mahin & Cate, No. 91-2637, 1992 U.S. App. LEXIS 12030, at *17 (7th Cir. May 18, 1992) (affirming dismissal of law firm partner's complaint concerning actions of management committee and including district report noting, in part, "Roan received what he bargained for.").

trol as a product of private ordering is established through the expression of will of a control group (or a control partner).

The weakness of the presumption is its inconsistency with partnership law's very straightforward approach to firm governance and the importance it accords the will of each partner. Partnership law's default norms limit the scope of action by majority vote.[48] The majority may act to resolve differences relating to the ordinary course of business but may not force its will on a single partner on matters beyond the ordinary course of business or issues fundamental to the partnership agreement. By combining a comparatively weak decision-making structure with the significant rights accorded each partner to participate in management of the firm, the default norms of partnership law provide a governance framework that is grounded in consent expressed on an ongoing basis. Significantly, these default norms supposedly represent the bargains that most partners would reach if they had reached specific agreements on firm structure.

Whatever may be said about such a framework for a firm with a small number of participants who interact frequently, larger firms of necessity must opt for more centralized (and less participatory) management. Such firms typically vest management in a small group, or even a single partner. When this happens, the agreement lends authority to management because it outlines the process by which the managers are chosen and removed. Although centralized management may be based upon an underlying agreement, its effect is to reduce sharply or eliminate altogether ongoing inclusive bargaining within a partnership. The more significant bargaining may be that which occurs to establish and maintain a control group within the partnership. Such private ordering may be selective in its exclusion of partners, and although its existence may be unsurprising in the context of large firms, it also is an activity far removed from the egalitarian model on which partnership law is based.

Moreover, if the centralized management governance structure of large partnerships may be said to reflect bargaining because it is an expression of a control group, then the distinction between partnerships and corporations blurs and both may be said to be grounded on governance by agreement. Indeed, the importance of organizational form may decline as the size of a firm increases.[49] To the extent that authorizing and ratifying votes by the firm owners is a standard for agreement-based systems of governance, then there seems to be little practical distinction between corporations and partnerships when either form of firm is populated by a large number of shareholders or partners, as the case may be.[50]

48. *See supra* text accompanying notes 30–32.

49. This discussion does not reflect the tax aspects of the organizational form, which in many cases are of significant importance.

50. For a discussion of why the partnership form of organization may be suitable for large firms, see Larry E. Ribstein, *Why Corporations?*, 1 BERKELEY BUS. L.J. 183 (2004).

VIII. DOMINANT PARTNERS, EASY EXIT, AND PRIVATE ORDERING: FURTHER LIMITATIONS ON BARGAINING

Although large firms, to one degree or another, depart from an egalitarian model of partnerships, even small firms may operate as hierarchical partnerships in which the dominance of one partner (or group of partners) negates meaningful bargaining among the partners over firm structure and operation. Indeed, some of the classic cases in partnership law involve small firms with dominant partners.

The facts in these cases all share a common denominator. Partners commence their relationship, with or without a formal agreement, on the assumption that they will be making equal contributions to their venture and will divide the income on this basis. Over time it becomes apparent that, by virtue of skills, personality, perseverance, or some other factor, one partner emerges as critical to the success of the venture. Inevitably, this partner begins to chafe at income sharing based on equality rather than contributions to the firm. In some cases, the problem is addressed by allocating the partner a greater proportion of the firm's income. If this does not happen, the partner may leave the firm and take the business, which has the operative effect of simply removing the unwanted and less productive partners from the firm.

For example, *A* and *B* establish a partnership to provide tax return preparation services. The firm struggles for a number of years, and the limited success it has is due to the hard work and pleasing personality of *A*. As a result of a major real estate development in the area, the firm's fortunes change and its future brightens. *A* is unwilling to continue the present arrangement with *B* and demands virtually all of the firm's income going forward to reflect his greater contributions. *B* feels this is contrary to the understanding on which the firm was established. *A* leaves the firm and opens up a tax return preparation service across the street.[51]

Partnership law facilitates just this maneuver by allowing dominant partners to negate prior bargains. One of the more important distinctions between partnership law and corporate law is the ease with which partnerships may be dissolved. Easy exit allows dominant partners to

51. Although many partnership cases fit this pattern, the example used here is drawn from one of the classic partnership decisions. In *Page v. Page*, 359 P.2d 41 (Cal. 1961), two individuals formed a partnership by means of an oral partnership agreement. For nearly a decade they struggled to keep their firm, a linen supply business, afloat. When prospects for the firm improved suddenly, one of the partners decided to end the relationship and pursue the prospects without the baggage of having an unnecessary partner demanding a share of the profits. Although the court warned this partner not "to appropriate to his own use the new prosperity of the partnership without adequate compensation to his co-partner," *id*. at 45, the partner had little to fear that the value of any part of the "new prosperity" of the firm could actually be claimed by his former colleague. *Id.* at 45. This was because a significant part of the value of the firm rested in the services he provided and would be beyond the reach of the liquidation process. For a discussion of *Page* and similar cases, see Hillman, *supra* note 37, at 19–33.

eliminate their weaker colleagues and, in the process, liberate themselves from prior bargains no longer in their interest. In theory, the liquidation process that follows dissolution should, at the least, insure that a dominant partner desiring to continue the business following dissolution pays fair value for the interest of another partner.

The reality departs from the theory, however, when a dominant partner is able to use dissolution as a means of capturing firm value without compensation to other partners. For example, if the real value of the firm rests in the unique contributions or services of the dominant partner, the most important component of firm value may be removed from the firm by this same partner without compensation to other partners. Alternatively, when the dominant partner is uniquely positioned to capture the value of a firm's assets that are being auctioned, the partner may utilize partnership law's liquidation procedures as a means of securing clear title to these assets for a token payment.

When partner dominance is apparent at the inception of a relationship the agreement struck by the partners may reflect the anticipated disparate contributions of the partners to the firm. Assuming relative contributions do not change after that point, the agreement may remain responsive to the expectations of the partners and mitigate any desire the dominant partner may have to restructure the relationship through the tactic of dissolution. When contributions to the firm depart from the original expectations reflected in the partnership agreement, however, an incentive may exist either to rebargain or to remove weaker partners from the firm through dissolution or related tactics.

Often, partners establish a relationship premised on the assumption that contributions to the firm will be relatively equal, but the passage of time reveals the assumption to be ill-founded. When this happens, the dominant partner may seek to restructure the relationship by rebargaining the original agreement or may, once again, remove weaker partners from the firm. In either case, partners who are subject to such actions may, with some justification, question the value and role of the initial agreement under which the relationship was first established.

Whether the above scenarios reaffirm the role of contract, or highlight its limitations, is a function of one's perspective on the rebargaining of contracts. If the importance of contract in partnership law is the distinction it offers from a system in which the structure of relationships is mandated by statute, then partnership law unquestionably rests on a contractarian foundation. If, on the other hand, the contract is to perform an important role ex ante in structuring the relationship among partners, its use is more limited because of the extent to which partnership law facilitates dominant partner rebargaining of prior agreements.

The limitations of contract in dominant partner scenarios hold true whether one views the contract as an attempt to freeze at a moment in time a statement of duties or in a more relational sense as a framework

for making adjustments is an ongoing and dynamic relationship. In either case, partnership law's easy exit provisions may provide the dominant partner with the means to achieve a greater percentage of firm income or management control (to identify just two objectives) than had been originally contemplated by the partners. This result is difficult to reconcile with the popular view of partnership law as supportive of agreement-defined relationships.

IX. BEYOND BARGAINING: CONTRA-CONTRACTARIAN THEMES IN PARTNERSHIP LAW

The discussion above illustrates how partnerships in practice may depart from the egalitarian model underlying partnership law and that such departures represent important limitations on bargaining in partnerships. The centralized management and dominant partner scenarios discussed above share the common theme of partnerships that have developed in ways that diminish the relevance of partnership law and its contractarian underpinnings.

Although partnership law has largely embraced the contract as a means of ordering relations within the firm, some aspects of partnership law itself contradict the bargaining norm of private ordering. For example, the Revised Uniform Partnership Act (RUPA) includes a laundry list of mandatory provisions that bargaining either cannot alter or may modify only within defined parameters.[52] The more important of these mandatory provisions include obligations of loyalty, care, and good faith,[53] as well as the power of a partner to withdraw from the partnership.[54]

Limits on waivers of standards of conduct (loosely speaking, fiduciary duties) significantly limit private ordering options available to partners.[55] The relevant provisions of RUPA are disjointed and read as if they were drafted by a committee, which they were. Indeed, the drafting committee was divided sharply on the limits of bargaining that lowers or eliminates altogether standards of behavior expressed in RUPA. The result, one of the least coherent portions of the statute, reflects a hard fought compromise between those who favor private ordering through bargaining and those who view RUPA's standards of conduct as a statement of core values and fundamental rights. The fact that the agreement may play a role in providing substantive meaning to duties may be seen as a victory for contractarians. Still, the underlying limitation of private

52. *See* RUPA § 103(b).

53. *See id.* § 103(b)(3)–(6).

54. *See id.* § 103(b)(6). In addition, RUPA restricts bargaining on access to books and records, *id.* § 103(b)(2), varying the filing and recording provisions, *id.* § 103(b)(1), and altering the power of a court to expel a partner. *Id.* § 103(b)(7).

55. *See generally* ROBERT W. HILLMAN, ALLAN W. VESTAL & DONALD J. WEIDNER, THE REVISED UNIFORM PARTNERSHIP ACT 35–50 (2003) [hereinafter HILLMAN, VESTAL & WEIDNER].

ordering in eliminating the duties altogether stands in sharp contrast to partnership law's overall deference to private ordering.[56]

An additional area in which partnership law limits bargaining options is withdrawal rights.[57] One of the distinctive features of partnership law is the right of any partner to exit the firm at any time.[58] No bargain is strong enough to bind a partner to a partnership. An agreement may specify disincentives for partner withdrawals, typically in the form of discounted buyouts, and a withdrawal in breach of contract may subject the exiting partner to a claim for damages. But the contract cannot waive the fundamental power of a partner to withdraw from the partnership.[59]

The exit rights of partners supposedly are necessary because a partnership is a highly personal relationship and partners carry the risk of unlimited liability for the acts of their colleagues. Withdrawal rights support the egalitarian model of partnerships in that they are grounded on the necessity of consent in partnership governance. This point was emphasized by the U.S. Supreme Court in a decision that influenced the drafters of the Uniform Partnership Act (UPA):

> *Every partnership creates a personal relation between the partners*, rests upon their mutual consent, and exists between them only . . . . No partnership can efficiently or beneficially carry on its business without the mutual confidence and cooperation of all the partners. Even when [the partners have agreed] the partnership shall continue for a certain period, the partnership may be dissolved at any time, at the will of any partner, so far as to put an end to the partnership relation . . . .[60]

As discussed above, it is no longer the case that "every partnership creates a personal relationship among the partners" resting on mutual consent. Although some partnerships do fit this description, the same can be said of close corporations, where exit rights are limited if they exist at all. Moreover, if unwaivable withdrawal rights are necessary because of the personal liability risks associated with partnerships, it is curious that the emergence of the limited liability partnership form of

56. Not surprisingly, legal academics are divided on the issue of bargaining and fiduciary duties. *See, e.g.*, J. Dennis Hynes, *Freedom of Contract, Fiduciary Duties, and Partnerships*: *The Bargain Principle and the Law of Agency*, 54 WASH. & LEE L. REV. 439, 443 (1997) (stating that fiduciary duties should be of a default nature only); Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537, 594 (1997) (explaining that fiduciary duties should be waivable); Allan W. Vestal, *Fundamental Contractarian Error in the Revised Uniform Partnership Act*, 73 B.U. L. REV. 523, 524 (1993) (stating that RUPA overemphasizes the contractual nature of partnership at the expense of its fiduciary qualities).

57. *See* HILLMAN, VESTAL & WEIDNER, *supra* note 55, at 266–70.

58. *See* RUPA § 602 (providing that a partner has the right to withdraw at any time and specifying the consequences of a wrongful dissolution); UPA §§ 31, 38 (providing for the unrestricted power to withdraw and specifying the consequences of a withdrawal (dissolution) in contravention of the agreement).

59. *See generally* Robert W. Hillman, *Indissoluble Partnerships*, 37 U. FLA. L. REV. 691 (1985) (discussing the power of partners to withdraw and suggesting some contractual restrictions on withdrawals should be enforceable).

60. Karrick v. Hannaman, 168 U.S. 328, 334–35 (1897) (emphasis added).

association has not prompted a reexamination of the necessity of unrestricted withdrawal rights in partnerships where liability risks are sharply curtailed. In any event, partnership law extends exit rights further than may be necessary, and in so doing weakens the very agreement that supposedly defines and governs the relationship among partners.

Although RUPA retains UPA's limitations on bargaining over withdrawal rights, it does elevate the role of the agreement in mitigating the impact of a withdrawal on the partnership.[61] For reasons that are discussed below, this important evolution of partnership law draws from the "entity theory" commonly associated with corporate law, and in this sense we may say corporate law is influencing the development of partnership law.

X. CORPORATE LAW'S INFLUENCE ON PARTNERSHIP LAW: THE TRIUMPH OF THE ENTITY OVER THE RELATIONSHIP, OR DOES IT REALLY MATTER?

Corporate law affecting closely-held firms has moved closer to partnership law in important respects, most notably in recognizing a role for agreements in structuring relationships among owners as well as the development of enhanced fiduciary duties regulating the conduct of controlling parties. The ways that corporate law has influenced partnership law are less obvious but equally important.

A basic distinction between partnership law and corporate law has been their varying conceptions of the core nature of the business association. Until recently, partnership law regarded the essence of the firm as the relationship among the partners, an approach that often is described as an aggregate view of the association, with the aggregation being the individuals joined together in the partnership.[62] In contrast, corporate law recognizes an overriding entity that exists independent of the owners of the firm and, in many respects, is unaffected by changes in their relationships. The distinction is formalistic but important. One branch of law focuses on the relationship, the other branch of law supersedes the relationship through the fiction of the firm.[63]

Emphasis on the relationship among partners, rather than the relationship between an entity and its owners, supports private ordering rather than mandatory rules as the basis for firm governance. Because the partnership is nothing more than a relationship among individuals,

61. *See, e.g.*, RUPA § 801 (limiting the circumstances under which a partnership formed for an agreed term or undertaking dissolves by virtue of a partner's withdrawal). *See generally* HILLMAN, VESTAL & WEIDNER, *supra* note 55, at 308–12.

62. The importance of the relationship is evident in the definition of a partnership as "an *association* of two or more persons to carry on a business for profit." *See* RUPA § 101(6); UPA § 6(1).

63. For a discussion of overuse of the aggregate-entity distinction, see Gary S. Rosin, *The Entity-Aggregate Dispute: Conceptualism and Functionalism in Partnership Law,* 42 ARK. L. REV. 395, 466 (1989) (favoring the "functional approach" of the UPA over the entity orientation of RUPA).

the aggregate view holds that it does not survive the departure of a single partner. Accordingly, even large firms effectively must re-form as new partnerships each time a partner dies or withdraws from the firm. Moreover, differences among partners as to relatively minor matters may be resolved by majority vote, but decisions on matters of significance require unanimity because of their effect on the agreement among partners. From a formalistic perspective, these characteristics establish a partnership as a relationship grounded in contract, rather than a firm with a legal personality independent of that of its members.[64]

Although the aggregate view of the firm offers a theory of partnerships that is both elegant and cohesive, its application has given rise to considerable confusion and mischief. Dissolution is a concept easily understood when applied to an entity such as a corporation. Where the entity does not exist, as in partnership law, there may be uncertainty over precisely what is being dissolved. The UPA makes clear that dissolution relates to the relationship, with the consequence that a partnership (the original relationship) dissolves with the departure of even a single partner.[65] Many partners and courts, however, either have struggled with this as a conceptual matter or are unwilling to accept the results that flow from an aggregate view of the partnership. Such was the concern over the uncertainties and confusion surrounding the term "dissolution" that Dean Donald Weidner, the Reporter on the RUPA drafting project, attempted to drop the term altogether from the statute.[66] He later commented that the survival of the dreaded "D word" was "RUPA's most notable failure to abandon a problematic approach."[67]

RUPA addresses the practical difficulties of partnership reformations as well as the confusion surrounding the concept of dissolution by abandoning the aggregate model in favor of a corporate-type entity structure for partnerships.[68] The point is made rather clearly in the stat-

64. The entity versus aggregate issue is a very old debate in partnership law. *See, e.g.,* Judson A. Crane, *The Uniform Partnership Act—A Criticism*, 28 HARV. L. REV. 762, 766–68 (1915) (criticizing the aggregate view); William D. Lewis, *The Uniform Partnership Act—A Reply to Mr. Crane's Criticism,* 29 HARV. L. REV. 158, 291–96 (1916) (defending the UPA's rejection of an entity view).

65. The poster child for reform of UPA was *Fairway Development Company v. Title Insurance Company of Minnesota*, 621 F. Supp. 120 (N.D. Ohio 1985), where a partner's death dissolved the partnership and necessitated the formation of a new partnership, with the unintended consequence that the successor partnership lacked standing to enforce a title insurance policy issued to the former partnership. *Fairway Development* is consistent with the UPA's treatment of the partnership as an aggregate of individuals, although the result reached in the case is harsh and rests on a literalism many other courts have been able to avoid.

66. *See* Donald J. Weidner, *Pitfalls in Partnership Law Reform: Some United States Experience*, 26 J. CORP. L. 1031, 1031–33 (2001).

67. *Id*. at 1031.

68. The RUPA project was launched at the urging of an ABA subcommittee, which recommended the implantation of an entity theory in the new statute whenever possible. *See* UPA Revision Subcomm. of the Comm. on P'ships & Unincorporated Bus. Orgs., *Should the Uniform Partnership Act Be Revised*?, 43 BUS. LAW. 121, 123–24 (1987). The Reporters on the RUPA project, however, later stated the RUPA drafting committee began its work without a clear preference of the entity over

ute itself: "A partnership is an entity distinct from its partners."[69] The troublesome "D word" has been tamed by the introduction of the term "dissociation" to describe withdrawals and, more importantly, the relegation of the term dissolution to mark the demise of the partnership as an entity.[70] The important consequence of this development is that under RUPA the partnership as an entity may survive the withdrawal of a partner.[71] The elevation of the entity makes the partnership more like the corporation.

There has been a noteworthy interplay over the last several decades between corporate law and partnership law on the issue of firm dissolvability. On the corporate law front, some statutes and courts have attempted to create a partnership-type freely dissolvable entity for close corporations under circumstances where a disgruntled minority shareholder seeks dissolution as a means of gaining an exit option and liquidity. The intellectual spark for this movement was provided by a 1977 law review article describing the close corporation as the "functional equivalent" of the partnership, and arguing for partnership-type liquidity in the close corporation setting.[72] The approach is most evident in jurisdictions offering minority shareholders relief based upon "frustrated expectations," or some similar state of mental agitation.[73]

At the same time partnership law has influenced corporate law's exit options for minority shareholders, corporate law has influenced RUPA's acceptance and implementation of the entity view to promote the stability of partnerships. RUPA's mandatory buyout provisions are modeled in part on the appraisal rights accorded dissenting shareholders under corporate law.[74] Enhanced liquidity rights for shareholders in close corporations, in turn, show the influence of the UPA's norm of freely dissolvable partnerships. Differences remain but are narrowing,

the aggregate view. *See* Donald J. Weidner & John W. Larson, *The Revised Uniform Partnership Act: The Reporters' Overview*, 49 BUS. LAW. 1, 3 (1993).

69. *See* RUPA § 201(a).

70. *See id*. § 801. Dissolution does not mark the termination of the entity because the partnership may continue for a period of time to wind up its business. *Id*. § 802(a).

71. Although on the surface this represents a major shift in the theory underlying partnership law, as a practical matter many partners and a growing number of courts were treating partnerships as entities long before RUPA arrived on the scene. *See, e.g*., SRI Corp. v. First Nat'l Bank of Rock Island, 393 N.E.2d 1287, 1291 (Ill. App. Ct. 1979) (holding that a change in the membership of the partnership did not cause a dissolution of the firm when the partnership agreement provided for dissolution only upon a vote of the partners). *See generally* LAWYER MOBILITY, *supra* note 34, § 4.3.2 (discussing cases departing from the UPA's dissolution norms).

72. *See* J.A.C. Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 6 (1977).

73. For discussions of relief available to minority shareholders based upon the frustration of their expectations, see Hillman, *supra* note 37, at 49–55; Douglas K. Moll, *Shareholder Oppression & "Fair Value": Of Discounts, Dates, and Dastardly Deeds in the Close Corporation*, DUKE L.J. (forthcoming 2004); Robert B. Thompson, *Corporate Dissolution and Shareholders' Reasonable Expectations*, 66 WASH. U. L.Q. 193 (1988).

74. *See* RUPA § 701.

and the reciprocal influences of partnership law and corporate law on the important questions of stability and liquidity are apparent.

To be sure, partnership law's abandonment of the aggregate view in favor of an entity approach is not complete. Just as the UPA's aggregate model admitted some compromises in favor of an entity view, RUPA departs from an entity view in a few important respects, most notably the joint and several liability of partners.[75] Partnership law's commitment to vicarious liability, however, is tentative at best. The rapid emergence and acceptance of limited liability partnerships, a development accommodated by RUPA itself,[76] reflects a corporate-type view of the partnership as an entity that attempts to distance owners from the debts of their firms. Although limited liability is not an essential characteristic of legal entities,[77] it is closely identified with the corporate form of organization, and the development of the LLP may be seen as a way to make partnerships more like corporations. This represents a reversal of the common view of partnership law as a source of influence on corporate law.

XI. CONCLUSION

There are not one but two corporate laws. For nearly a century, one of these corporate laws gradually, and with little fanfare, has been evolving as a set of norms for closely-held firms that tolerates and even encourages private ordering through bargaining. This evolution has been influenced by partnership law and the perception that closely held firms truly are partnerships trapped in the corporate form.

There is only one partnership law, but this is a law that an increasing number of partnerships have outgrown. As a firm increases in size, and its partners number in the hundreds or thousands, prospects dim for broad-based partner participation in developing and adjusting an agreement structuring their relationships. Large firms necessarily become hierarchical partnerships. Although a tiered structure is tolerated by partnership law, it is hardly consistent with the egalitarian norms reflected in the traditional conception of a partnership. Moreover, even small partnerships may be controlled by dominant partners who embrace private ordering in ways that may undermine the bargaining-among-equals premise that underlies much of partnership law.

The argument for relaxing statutory mandates for closely-held firms is that the participants in such firms should be able to structure their relationships through private ordering. For many firms, bargaining provides the optimal means of structuring relationships among the participants. A

75. *See id.* § 306(a). For an argument that limited liability should be default norm for closely-held firms, see Larry E. Ribstein, *The Evolving Partnership*, 26 J. CORP. LAW 819, 835–43 (2001).

76. *See* RUPA § 306(c).

77. For a discussion of this point and the development of limited liability in the corporate setting, see Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573 (1986).

decline in statutory mandates, however, is not necessarily matched by an increase in private ordering through bargaining. This is largely, but not exclusively, a function of size, and we have yet to address adequately the growing number of firms that are unable or unwilling to implement an approach to firm structuring and governance grounded in true bargaining.