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## Good Faith in Partner Expulsions: Application of a Contract Law Paradigm

*Jeff Schwartz\**

### I. INTRODUCTION

It is a central tenet of partnership law that partners are generally free to abandon the partnership at any time.<sup>1</sup> But may the partnership abandon them? The issue of when partners may expel their peers has recently arisen as an important one in partnership law, and one that has belied steady and fair treatment. The underlying statutes that govern partnerships do not give partners the right to expel.<sup>2</sup> The opportunity to take such action only exists if it is conferred in the partnership agreement.<sup>3</sup> Moreover, expulsions pursuant to these agreements are only proper if undertaken in good faith.<sup>4</sup>

The interpretation of good faith has proven especially troublesome. Ousted partners have suggested that the term requires certain procedural and substantive safeguards.<sup>5</sup> For instance, it is commonly claimed that partners were expelled in bad faith because they were not permitted to defend themselves (exemplifying a procedural objection) or because there was no legitimate business reason to let them go (a substantive complaint).<sup>6</sup>

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<sup>1</sup> UNIF. P'SHIP ACT § 31 (1914). Note, however, that if a partner leaves the partnership before the expiration of the partnership's term or the accomplishment of a specific undertaking, that person will be in breach of an agreement among the partners; *see id.* at § 31(2).

<sup>2</sup> *See* UNIF. P'SHIP ACT § 31(d) (1914); REVISED UNIF. P'SHIP ACT § 601(3) (1997).

<sup>3</sup> UNIF. P'SHIP ACT § 31(d) (1914); REVISED UNIF. P'SHIP ACT § 601(3) (1997).

<sup>4</sup> UNIF. P'SHIP ACT § 31(d) (1914); REVISED UNIF. P'SHIP ACT § 404(d) (1997) (addressing the good faith obligation that is generally applicable to partnership dealings).

<sup>5</sup> *See* *Holman v. Coie*, 522 P.2d 515, 519 (Wash. Ct. App. 1974).

<sup>6</sup> *See id.* at 519.

Courts have yet to settle on a satisfactory approach to contentions such as these. A workable framework, however, can be developed if the confines of partnership law doctrine are left behind; although partner expulsions are an issue unique to this area of law, the notion of good faith is not.<sup>7</sup> This article suggests a framework that relies on the concept of “forgone opportunity analysis” developed for application to questions of good faith in contractual performance.<sup>8</sup> This mode of analysis first looks at what motivated the expelling partners’ actions (e.g., why did they expel this partner?), and then asks whether acting for this purpose was an opportunity that the parties surrendered under the partnership agreement. This latter inquiry is determined by the ousted partner’s expectations at the time this individual agreed to the expulsion provision.<sup>9</sup> If the remaining partners are exercising their discretion in a manner that falls outside the reasonable expectations of the ousted partner, then they are acting with bad faith.

The first part of this article describes the general statutory rules and common law principles that inform the analysis of partner expulsions. Next, this article addresses the specific approaches to the issue developed in the case law and analyzes why each is inadequate. Finally, a new framework is presented and its implications are explored.

## II. GENERAL STATUTORY AND COMMON LAW SCHEME

State statutes form the basis of partnership law. These statutes are, for the most part, derived from one of two model codes: the Uniform Partnership Act (UPA) or the revised version of the Uniform Partnership Act (RUPA). Though RUPA departs from UPA in many respects, the statutes treat the topic of partner expulsion similarly: it is only permitted if the right is granted in the partnership agreement<sup>10</sup> and undertaken in good faith. Thus, if several parties enter into a partnership, they generally will not have the power to expel. But if they so choose, they may include the right in their partnership agreement. Under the uniform acts, the exercise of the right will be respected so

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<sup>7</sup> The obligation to perform one’s contractual duties in good faith is well embedded in contract law; *see, e.g.*, U.C.C. § 1-304 (2003); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

<sup>8</sup> Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369 *passim* (1980) (the seminal article presenting this theory).

<sup>9</sup> *Id.*

<sup>10</sup> UNIF. P’SHIP ACT § 31(d) (1914); REVISED UNIF. P’SHIP ACT § 601(3) (1997).

long as it is carried out in good faith and according to the terms of their agreement.

Determining whether a particular expulsion complies with the language guiding its use is fairly straightforward. But judging good faith has proven challenging, in part because there is no uniform definition of good faith or even agreement as to the source of the obligation.

Traditionally, good faith has been conceptualized as a component of the fiduciary duty of loyalty.<sup>11</sup> The duty of loyalty is seen as imposing dual requirements on partners. One serves to protect the business of the partnership. The other – the duty of good faith – protects the partners themselves. In order to protect the business of the partnership, partners are forbidden from putting their own interests ahead of the partnership.<sup>12</sup> Thus, as an example, they may not seize an opportunity for themselves that rightfully belongs to the partnership<sup>13</sup> or take intellectual property from the business for use in their own personal endeavors.<sup>14</sup> Under the duty of good faith, partners are required to treat each other with a degree of honesty and respect that goes beyond what is expected of parties interacting at arms-length.<sup>15</sup>

More recently, courts and scholars have begun to question whether this latter obligation is properly viewed as part of the duty of loyalty.<sup>16</sup> Partners are bound by the duty of loyalty, they argue, because each is an agent of the partnership.<sup>17</sup> As such, a partner is given authority over partnership business. For exam-

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<sup>11</sup> *Newburger, Loeb & Co. v. Gross*, 563 F.2d 1057, 1078 (2d Cir. 1977) (defining the duty of loyalty as “utmost good faith, fairness, [and] loyalty”); *see also* Allan W. Vestal, *Law Partner Expulsions*, 55 WASH. & LEE L. REV. 1083, 1140 (1998) [hereinafter Vestal, *Expulsions*].

<sup>12</sup> HAROLD GILL REUSCHLEIN & WILLIAM A. GREGORY, *THE LAW OF AGENCY AND PARTNERSHIP* 278-79 (2d ed. 1990).

<sup>13</sup> *See, e.g., Meinhard v. Salmon*, 164 N.E. 545, 548 (N.Y. 1928).

<sup>14</sup> *See, e.g., Gibbs v. Breed, Abbott & Morgan*, 710 N.Y.S.2d 578, 582-83 (N.Y. App. Div. 2000).

<sup>15</sup> Allan W. Vestal, *Fundamental Contractarian Error in the Revised Uniform Partnership Act of 1992*, 73 B.U. L. REV. 523, 526 (1993) (citing EUGENE A. GILMORE, *HANDBOOK ON THE LAW OF PARTNERSHIPS, INCLUDING LIMITED PARTNERSHIPS* 375 (1911) (“The duty of each partner to exercise toward the others the highest integrity and good faith is the very basis of their mutual rights in all partnership matters.”); *see* 2 ALAN R. BROMBERG & LARRY E. RIBSTEIN, *BROMBERG AND RIBSTEIN ON PARTNERSHIP* 6:146-47 (2005).

<sup>16</sup> *See, e.g., Paula J. Dalley, The Law of Partner Expulsions: Fiduciary Duty and Good Faith*, 21 CARDOZO L. REV. 181, 183 (1999).

<sup>17</sup> *Id.* at 189.

ple, any partner may bind the partnership to an agreement.<sup>18</sup> In this relationship, unique potential for abuse exists: partners may take advantage of this position of trust to advance their own interests (e.g., by getting a kickback for choosing a certain vendor). And this is what the duty of loyalty forbids.

The duty of loyalty is unrelated to transactions between partners that do not involve one partner exercising control over the partnership business, because outside of this context, there is no special risk of exploitation. Since there is nothing exceptional about dealings between partners *inter se*, they should be treated like normal contracting parties. Such parties are bound by an obligation of good faith, which is read into every contract. Thus, according to this theory, partners should be bound by good faith as defined in contract law, but any higher duty arising out of the fiduciary relationship is ill-conceived.<sup>19</sup>

Turning to contract law precedent, however, does not offer much guidance on the standard for measuring whether a particular action is in good faith.<sup>20</sup> In fact, neither partnership nor contract cases have devised a consistent definition of the doctrine, and it has been no different in the limited context of partner expulsions.

### III. EXPULSION CASE LAW

Cases have applied the duty of good faith to partner expulsions in myriad ways. At the most general level, however, courts have been fairly consistent in that they have viewed good faith from a fiduciary duty perspective<sup>21</sup> (though some of these cases have included brief analyses of the contractual duty of good faith in addition to their fiduciary duty discussions).<sup>22</sup>

The different approaches to analyzing good faith as a fiduciary duty can be grouped into three categories. Some cases set out a rule that good faith generally requires expulsion be justi-

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<sup>18</sup> UNIF. P'SHIP ACT § 9 (1914); REVISED UNIF. P'SHIP ACT §301 (1997).

<sup>19</sup> Dalley, *supra* note 16, at 189-90.

<sup>20</sup> See E. Allan Farnsworth, *Good Faith in Contract Performance*, in GOOD FAITH AND FAULT IN CONTRACT LAW 153, 161-63 (Jack Beatson & Daniel Friedman eds., 1995) (discussing the different conceptualizations of the duty of good faith in contract law).

<sup>21</sup> See, e.g., *Gibbs v. Breed, Abbott & Morgan*, 710 N.Y.S.2d 578, 581 (N.Y. App. Div. 2000) (partners are fiduciaries and as such have a duty of good faith toward one another); see also *Gigax v. Repka*, 615 N.E.2d 644, 649-50 (Ohio Ct. App. 1992) (holding the same).

<sup>22</sup> See, e.g., *Holman v. Coie*, 522 P.2d 515, 523-24 (Wash. Ct. App. 1974).

fied by a legitimate business purpose.<sup>23</sup> Others follow a contrary reading of good faith: one that permits expulsion unless the remaining partners used the mechanism to wrongfully promote their own economic interests.<sup>24</sup> Finally, some follow no general rule at all; instead they look at each expulsion on a purely case-by-case basis.<sup>25</sup>

None of the above perspectives present an adequate means of addressing good faith, and the results are likewise unsatisfying when courts analyze the concept as a contractual obligation.

#### A. Legitimate Business Purpose

In certain circumstances, courts have read the duty of good faith to generally require that expulsion be justified by a legitimate business purpose. One case that clearly embraces this approach is *Gigax v. Repka*.<sup>26</sup> In this case, the plaintiff, Robert Gigax, and two other individuals were shareholders and directors of a close corporation involved in the sewage treatment business.<sup>27</sup> Each of them also served as company employees, although none had an employment agreement.<sup>28</sup> Over plaintiff's fourteen year tenure, he held many positions, including six years as president.<sup>29</sup> Eventually, however, according to his fellow shareholders, his performance began to suffer, resulting in lower profits on projects to which he was assigned.<sup>30</sup> And so they let him go.<sup>31</sup>

Gigax brought suit and alleged that, in firing him, the other shareholders breached their fiduciary duties.<sup>32</sup> Though the parties were technically involved in business together under the corporate form, the court turned to partnership law to consider this aspect of the case, finding partnership analysis appropriate because of the close resemblance between partnerships and close

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<sup>23</sup> See, e.g., *Gigax*, 615 N.E.2d at 650.

<sup>24</sup> See *Holman*, 522 P.2d at 523.

<sup>25</sup> See *Winston & Strawn v. Nosal*, 664 N.E.2d 239, 243 (Ill. App. Ct. 1996).

<sup>26</sup> *Gigax*, 615 N.E.2d at 650; see also *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976) (holding that courts should weigh the legitimate business purpose involving an expulsion); *Cruz v. S. Dayton Urological Assoc., Inc.*, 700 N.E.2d 675, 679-80 (Ohio Ct. App. 1997) (holding the same).

<sup>27</sup> *Gigax*, 615 N.E.2d at 646.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> See *id.* at 646-47.

corporations.<sup>33</sup> From partnership law, the court borrowed the following proposition: “[t]he fiduciary duty [including the duty of good faith] which the partners owe each other requires that the removal of a partner be based on legitimate business reasons.”<sup>34</sup> The court, in applying this rule, found that the partners did not prove that there was a legitimate business reason to fire the plaintiff because the decline in profitability that arose in connection with the plaintiff’s projects was not necessarily his fault.<sup>35</sup>

Since this case did not involve contractual provisions relating to expulsion, the court was able to consider good faith in the abstract. It was not forced to think about the impact of specific contractual language with respect to the topic. For instance, it did not address whether cause should be required despite express language specifying that expulsion could be legitimately undertaken without it.

Because the court did not look at good faith in the context of specific language on the topic, the rule it applied – that good faith requires cause – is overly simplistic. Partnership law is unique in that it allows the partners to control many of the terms of their relationship through agreement; the statutory rules are for the most part merely default provisions.<sup>36</sup> There are, however, some rules that cannot be contracted out of (e.g., partners can not agree to completely eliminate fiduciary duties).<sup>37</sup> Which rules these should be is a considerable topic of debate, a debate that springs from a basic tension in the law of partnership.<sup>38</sup> On the one hand, the law is designed to be flexible, allowing numerous types of business relationships in order to fit the parties’ needs. On the other hand, there are certain basic attributes of the partnership relationship that come with being a partner, and as such cannot be altered. When a court simply says that a legitimate business purpose is required, it is ignoring this tension, failing to consider whether the cause requirement is something the part-

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<sup>33</sup> *Gigax*, 615 N.E.2d at 648.

<sup>34</sup> *Id.* at 650.

<sup>35</sup> *Id.*

<sup>36</sup> See, e.g., REVISED UNIF. P’SHIP ACT § 103 (1997) (specifying those areas where the partnership agreement may not deviate from the Act).

<sup>37</sup> See REVISED UNIF. P’SHIP ACT § 103(b)(3).

<sup>38</sup> 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, 454 (1997) (arguing that freedom of contract allows the waiver of a fiduciary duty). But see Allan W. Vestal, “Assume a Rather Large Boat . . .”: *The Mess We Have Made of Partnership Law*, 54 WASH. & LEE L. REV. 487, 530 (1997) (arguing that fiduciary duties are assumptions of the common law and therefore cannot be waived).

ners can dispose of when setting up the terms of their relationship.

One commentator has undertaken a closer examination of the wisdom of requiring cause in partner expulsions, in the process developing a theory that takes into account what the parties have agreed to with respect to the topic.<sup>39</sup> According to this mode of analysis, a cause requirement should be imposed only when “faithful to an agreed upon purpose and consistent with the justified expectations of the partners at formation, or when the circumstances make such a requirement a tool for achieving fairness.”<sup>40</sup> Good faith would not require expulsion be justified by a legitimate business purpose if the partnership agreement specifically provided otherwise.<sup>41</sup>

This analysis is a step forward in that it acknowledges that a proper interpretation of the duty of good faith must look to the partnership agreement and the partner’s expectations. This framework, however, is also imperfect. First, it gives little guidance to the courts about how to determine whether cause should be implied when the agreement is silent. As quoted above, in order to make this judgment, the test relies specifically on “fairness” – a particularly ambiguous word in the law.

Additionally, and more importantly, to look at good faith in terms of whether it requires cause is only part of the necessary analysis. In each case, the partner will have been expelled for some reason. As explored in more detail below, the important question is whether this motivation was proper.<sup>42</sup> The parties’ intentions as to cause are only relevant to the extent they inform this inquiry. For instance, if a partnership agreement explicitly states that expulsion need not be “for cause,” then this supports an argument that expulsion for minor misconduct is appropriate. But the key question is whether the particular motivation for this expulsion was acceptable. The parties’ expectations concerning the motivation at issue are most telling; their thinking as to cause is one of many pieces of evidence that may shed light on this issue.

The focus on causation is therefore inadequate. The rule explored below, which defines bad faith as precluding certain financially-motivated ousters, is also unsound.

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<sup>39</sup> See Vestal, *Expulsions*, *supra* note 11.

<sup>40</sup> Vestal, *Expulsions*, *supra* note 11, at 1134.

<sup>41</sup> Vestal, *Expulsions*, *supra* note 11, at 1135.

<sup>42</sup> See *infra* Part IV. FORGONE OPPORTUNITY ANALYSIS.



B. *Holman* and its Progeny: Economic Self-Gain and Contractual Plain Meaning

Under economic self-gain analysis, good faith is read only to require that partners not use expulsion to misappropriate property rightfully belonging to the excluded partner. The seminal case is *Holman v. Coie*.<sup>43</sup> Here, two brothers, William and Francis Holman, were partners of a 22-member law firm in Washington state.<sup>44</sup> The partnership agreement to which they were parties provided for expulsion.<sup>45</sup> The applicable provision, however, was quite terse, permitting expulsion by majority vote of the firm's executive committee, but not specifying what justifications would suffice.<sup>46</sup>

Pursuant to this provision, the executive committee ejected the Holman brothers.<sup>47</sup> The committee members gave no reason for the expulsion. They did, however, present several possible justifications to the court. In sum, the other partners claimed that the Holmans had disrupted the collegiality of partnership meetings, and that Francis Holman, through his actions as state senator, had angered a major client.<sup>48</sup>

The Holmans challenged the expulsion, alleging they were treated with bad faith because they were not provided with notice, reasons for the action or an opportunity to be heard.<sup>49</sup> In analyzing these arguments, the court acknowledged that as fiduciaries, partners owe each other a duty of good faith, but said the obligation is only violated when expulsion is used to "gain [a] business or property advantage to the remaining partners."<sup>50</sup> The *Holman* court found that this was not the case, and therefore the Holmans' expulsion was in good faith.<sup>51</sup>

The court, however, did not end its analysis there. It also considered whether the expulsion violated the contractual duty of good faith. This doctrine, according to the court, is used to help interpret contracts.<sup>52</sup> Since, in the court's eyes, it was "clear from reading the agreement" that expulsion without cause, notice or an opportunity to be heard was a distinct possibility, it found it

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<sup>43</sup> *Holman v. Coie*, 522 P.2d 515 (Wash. Ct. App. 1974).

<sup>44</sup> *Id.* at 517, 519.

<sup>45</sup> *Id.* at 517.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.* at 517-19.

<sup>48</sup> *Id.* at 517-18.

<sup>49</sup> *Holman*, 522 P.2d at 519.

<sup>50</sup> *Id.* at 523.

<sup>51</sup> *Id.* at 524.

<sup>52</sup> *Id.* at 523-24.

unnecessary to appeal to the obligation of good faith for guidance.<sup>53</sup> Therefore, this doctrine could not lend support to the plaintiffs' claims. The court found that the agreement unambiguously denied the procedural protections claimed.<sup>54</sup>

*Holman's* approaches to good faith – both its fiduciary and contractual analyses – have been widely adopted.<sup>55</sup> Its fiduciary duty rule, which restricts good faith to economic predation, has been subject to two competing interpretations. Some courts have interpreted *Holman* as forbidding expulsion if carried out simply in order to increase the partnership share of the remaining partners. In *Heller v. Pillsbury Madison & Sutro*, a laterally-hired law firm partner repeatedly embarrassed the partnership and was therefore expelled.<sup>56</sup> When the expelled partner challenged the expulsion on good faith grounds, the court found that, as fiduciaries, “partners cannot expel another partner for self-gain.”<sup>57</sup> The court, however, concluded that this did not occur: “[w]hile [this partner’s] expulsion from the firm increased all Pillsbury partners’ profit shares, given the large number of partners . . . and the fact that Heller was earning toward the lower end of the firm’s compensation range, the increase was insubstantial.”<sup>58</sup> Moreover, the court held that the evidence indicated that the small increase in profits-per-partner was not the true motivation; rather, the partners had lost faith in this individual.<sup>59</sup> The court concluded that expulsion for this latter rationale was proper.<sup>60</sup>

In a similar case, *Cadwalader, Wickersham & Taft v. Beasley*, Beasley, a partner in the law firm’s Palm Beach office, was expelled.<sup>61</sup> At the time, the entire firm was struggling and the partnership was undertaking measures that would allow it to

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<sup>53</sup> *Id.* at 524.

<sup>54</sup> *Id.* at 521 (“In this case the express language of the partnership agreement itself must be controlling; that language clearly does not contain any of the [procedural protection] requirements plaintiffs now seek to assert as impliedly applicable. Where the terms of a contract, taken as a whole, are plain and unambiguous, the meaning is to be deduced from the contract alone.”).

<sup>55</sup> See, e.g., *Heller v. Pillsbury Madison & Sutro*, 58 Cal. Rptr. 2d 336, 347 (Cal. Ct. App. 1996).

<sup>56</sup> *Id.* at 339-41.

<sup>57</sup> *Id.* at 348 (quoting *Bohatch v. Butler & Binion*, 905 S.W.2d 597, 602 (Tex. App. 1995)).

<sup>58</sup> *Id.* at 348 (footnotes omitted).

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Cadwalader, Wickersham & Taft v. Beasley*, 728 So. 2d 253, 256 (Fla. Dist. Ct. App. 1998).

remain competitive.<sup>62</sup> Since Beasley's branch office was unprofitable,<sup>63</sup> the firm decided to close it, rendering Beasley's employment unnecessary.<sup>64</sup> The court found his expulsion to be a breach of the duty of good faith because its primary purpose was to increase the profits allocable to the remaining partners.<sup>65</sup>

The view expressed above is more favorable to the expelled partner than the alternative interpretation of the *Holman* rule. Under the latter approach, expulsion in order to increase profits-per-partner would be acceptable; the only restriction on using this mechanism is that the ousted partner must be fairly compensated for his or her partnership interest when expelled. For example, in *Lawlis v. Kightlinger & Gray*, the firm expelled a partner, Gerald Lawlis, under an expulsion provision that merely stated that "[a] two-thirds (2/3) majority of the Senior Partners, at any time, may expel any partner from the partnership upon such terms and conditions as set by said Senior Partners."<sup>66</sup> The court, in rejecting Lawlis's argument that his expulsion violated good faith, held that "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."<sup>67</sup> Since the severance package in this case was "compassionate," rather than "greedy," there was no evidence that Lawlis was treated wrongfully.<sup>68</sup>

In sum, *Holman's* focus on economic predation has been the subject of two conflicting interpretations: one finds bad faith when expulsion is carried out in order to increase the remaining partners' profit share; the other would strike down use of this mechanism only if the ousted partner is not given a fair buy-out.

To say *Holman* stands for the proposition that partners may not expel for self-gain is an oversimplification. If the rule was interpreted this way, then there would be practically no permissible rationale for its use. In *Holman*, for instance, the firm's main

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<sup>62</sup> *Id.* at 255.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Beasley v. Cadwalader, Wickersham & Taft*, No. CL-94-8646 "AJ," 1996 WL 43877, at \*6 (Fl. Cir. Ct. July 23, 1996), *aff'd in part, rev'd in part*, *Cadwalader, Wickersham & Taft v. Beasley*, 728 So. 2d 253 (Fla. Dist. Ct. App. 1998).

<sup>66</sup> *Lawlis v. Kightlinger & Gray*, 562 N.E.2d 435, 439-40 (Ind. Ct. App. 1990) (emphasis omitted).

<sup>67</sup> *Id.* at 443.

<sup>68</sup> *Id.*

client clearly wanted Francis Holman out.<sup>69</sup> Expulsion to please this client could be interpreted as motivated by self-gain – by getting rid of Holman, the partners help the firm business and indirectly their own personal finances as well. Yet, expulsion in order to save the firm from losing a major client was permitted in *Holman*, and is clearly acceptable under either of the interpretations of the rule discussed above.

No matter how *Holman* is construed, its rule is imperfect. Part of the problem is that the court employed overly simplistic logic in fashioning its rule. *Holman* begins with the premise that fiduciary duties prohibit partners from taking personal advantage of the partnership.<sup>70</sup> It then recognizes that in the expulsion context there is no claim that the partnership is being abused – the ones claiming malfeasance are the ousted partners.<sup>71</sup> But it presumes that this does nothing to change the focus of the inquiry. Instead, when considering whether expulsion comports with the duty of good faith, it focuses on the same issue mentioned above: whether the remaining partners gained any personal advantage.<sup>72</sup>

This reading of the fiduciary duty of loyalty fails to consider the full range of conduct to which this doctrine traditionally applies. As discussed above, this obligation encompasses two components.<sup>73</sup> The first requires that the partners not exploit the partnership; the second requires that they treat each other with good faith.<sup>74</sup> Each warrants independent analysis because each implicates unique issues. However, the court in *Holman* does not acknowledge the distinction, and this leads to an under-inclusive rule.

*Holman* only forbids expulsions where partners seek wrongful financial gain.<sup>75</sup> This concept is too restrictive. There are many non-financial motivations that could very well constitute bad faith. What if a partner is expelled out of personal spite? Or because of his or her race or gender? It seems that even the most restrictive definition of good faith would forbid expulsion if an

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<sup>69</sup> *Holman v. Coie*, 522 P.2d 515, 518 (Wash. Ct. App. 1974).

<sup>70</sup> *Id.* at 523.

<sup>71</sup> *See id.*

<sup>72</sup> *Id.*

<sup>73</sup> *See supra* Part II. GENERAL STATUTORY AND COMMON LAW SCHEME.

<sup>74</sup> *See supra* Part II. GENERAL STATUTORY AND COMMON LAW SCHEME.

<sup>75</sup> *See supra* Part III. B. *Holman* and its Progeny: Economic Self-Gain and Contractual Plain Meaning.

ousted partner could show such motivations.<sup>76</sup> The *Holman* rule, however, would allow ejections based on these and other similarly wrongful motives, and this is the central flaw in *Holman*'s analysis of good faith as a fiduciary duty.

The *Holman* court's analysis of good faith as a contractual imperative has also been widely followed<sup>77</sup> and is also lacking. As discussed above, *Holman* found that expulsion without giving a reason and without affording any procedural protections was clearly permitted by a partnership agreement that made no mention of these topics.<sup>78</sup> The court believed that there was no reason to look at whether good faith would require these protections, reading the agreement's silence with respect to these issues as an unambiguous denial of such safeguards.<sup>79</sup> Other cases looking at the contractual duty of good faith in similar circumstances have also restricted their analyses to the partnership agreement itself. In *Heller*, for example, the court found that an expulsion provision that gave little detail beyond authorizing its use unambiguously denied the procedural and substantive safeguards that the plaintiff sought, rendering the duty of good faith irrelevant.<sup>80</sup>

Though the framework for analyzing contract-based good faith adopted in *Holman* is in line with precedent, its application is superficial. The approach is correct when it recognizes that a court generally looks to good faith in trying to determine the parties' obligations when the contract is incomplete or ambiguous.<sup>81</sup> But it is overly simplistic for courts to say that the provision at issue is unambiguous with respect to the procedural and substantive safeguards under consideration just because an agreement is silent regarding these topics. Failure to mention these issues makes the contract ambiguous, leaving the court to deter-

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<sup>76</sup> See, e.g., Leonard M. Baynes, *Falling Through the Cracks: Race and Corporate Law Firms*, 77 ST. JOHN'S L. REV. 785, 830-31 (2003) (arguing that partner fiduciary duties should include nondiscrimination principles).

<sup>77</sup> See, e.g., *Heller v. Pillsbury Madison & Sutro*, 58 Cal. Rptr. 2d 336, 347 (Cal. Ct. App. 1996).

<sup>78</sup> See *supra* Part III. B. *Holman* and its Progeny: Economic Self-Gain and Contractual Plain Meaning.

<sup>79</sup> See *supra* Part III. B. *Holman* and its Progeny: Economic Self-Gain and Contractual Plain Meaning.

<sup>80</sup> *Heller*, 58 Cal. Rptr. 2d at 347.

<sup>81</sup> See, e.g., *Tymshare, Inc. v. Covell*, 727 F.2d 1145, 1152 (D.C. Cir. 1984) (noting the the significance of the doctrine of good faith in contract law is "in implying terms in the agreement") (quoting E. Allan Farnsworth, *Good Faith Performance and Commercial Reasonableness under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666, 670 (1963)).

mine whether – pursuant to the duty of good faith – these protections should be implied.

*Holman's* approach to both a status-based duty of good faith and its means of addressing allegations based on the contractual obligation have been widely followed. Despite the case's broad following, however, its does not appear to present an effective framework for addressing these issues.

### C. Case-by-Case Analysis

Both approaches toward the fiduciary duty of good faith discussed above analyze the problem in two steps. First, each sets out a rule based on a conception of what the substance of the duty actually is. Second, each looks to see whether the expelling partners' actions violate its rule. In *Gigax*, for example, the court set out the general rule that expulsions require a legitimate business purpose;<sup>82</sup> then, the court held that the duty of good faith was violated because the plaintiff was not expelled for a good reason.<sup>83</sup> In contrast, *Holman* set out a rule that good faith precludes only economic predation.<sup>84</sup> The *Holman* court then held that the good faith requirement had been met because there was no evidence of such misconduct.<sup>85</sup>

The next group of cases does not attempt to formulate a rule of general application and then apply it to the facts. Instead, the courts simply apply the amorphous doctrine of good faith to the circumstances of the case and make their decisions. One example is *Winston & Strawn v. Nosal*.<sup>86</sup> In this case, Chester Nosal was expelled from his position as a partner in his law firm.<sup>87</sup> He claimed he was ejected for his repeated requests for partnership records that, if turned over, would have revealed fraud by certain partners.<sup>88</sup> The remaining partners contended otherwise. They argued that he "was outplaced because his interest in building a two-pronged tax and international trade practice was incompatible with the interests and resources of the firm, and because he had engaged in 'disturbing' conduct."<sup>89</sup> The court found that if

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<sup>82</sup> *Gigax v. Repka*, 615 N.E.2d 644, 648 (Ohio Ct. App. 1992) (citing *Crosby v. Beam*, 548 N.E.2d 217, 221 (Ohio 1989)).

<sup>83</sup> *Id.* at 650.

<sup>84</sup> *Holman v. Coie*, 522 P.2d 515, 523-24 (Wash. Ct. App. 1974).

<sup>85</sup> *Id.* at 524.

<sup>86</sup> *Winston & Strawn v. Nosal*, 664 N.E.2d 239, 243-45 (Ill. App. Ct. 1996).

<sup>87</sup> *Id.* at 240.

<sup>88</sup> *Id.* at 243.

<sup>89</sup> *Id.* at 244.

Nosal's version was the more accurate, then his expulsion was in bad faith.<sup>90</sup> It made no attempt to explain its ruling by anything more specific than the fiduciary duty of good faith.

Another case that simply relied on the duty of good faith, without further definition, was *Bohatch v. Butler & Binion*.<sup>91</sup> Colette Bohatch had recently been promoted to partner in her law firm.<sup>92</sup> As a partner, she began receiving reports detailing the number of hours each attorney billed.<sup>93</sup> Based on her review, she became suspicious that the managing partner in her small branch office was overbilling clients.<sup>94</sup> She reported this to the firm's managing partner, who conducted an investigation.<sup>95</sup> This investigation showed that Bohatch's contentions were incorrect.<sup>96</sup>

Shortly after this episode, Bohatch was expelled.<sup>97</sup> She claimed it was for whistle-blowing;<sup>98</sup> the firm claimed it was because her allegations had created such a schism in her office that it was not feasible for her to continue with the firm.<sup>99</sup> However, the *Bohatch* court did not choose between these two rationales because under its view expulsion was justified even if the facts were read to support Bohatch's theory that her expulsion was retaliatory. The judge reasoned simply that her expulsion "for reporting suspected overbilling by another partner" was permissible.<sup>100</sup>

*Nosal* and *Bohatch* illustrate the central problem with the case-by-case approach. When courts simply jump from the duty of good faith to a holding on particular facts, the law is unpredictable. In fact, *Nosal* and *Bohatch* are completely at odds with each other. In both cases, the ejected partners were whistleblowers. In *Nosal*, the ejected partner was attempting to gain evidence of suspected misconduct before formally reporting it;<sup>101</sup> in *Bohatch*, the ejected partner reported the suspected misconduct

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<sup>90</sup> *Id.* at 246 (noting that there is a triable issue of fact regarding Nosal's expulsion).

<sup>91</sup> *Bohatch v. Butler & Binion*, 977 S.W.2d 543 (Tex. 1998).

<sup>92</sup> *Id.* at 544.

<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> *Bohatch*, 977 S.W.2d at 544-45.

<sup>98</sup> *Id.* at 546.

<sup>99</sup> *Id.* at 546-47 (discussing court's concern regarding the fundamental schism that may develop once one partner has accused another of misconduct).

<sup>100</sup> *Id.* at 547.

<sup>101</sup> *Winston & Strawn v. Nosal*, 664 N.E.2d 239, 243-44 (Ill. App. Ct. 1996).

prior to his expulsion.<sup>102</sup> The *Nosal* court found that a triable issue of fact existed as to whether the expulsion to prevent the exposure of information would be violative,<sup>103</sup> but in *Bohatch* expulsion as retaliation was permissible.<sup>104</sup> Lawyers should be able to guide their clients as to when expulsion is allowable under the law. The precedent created by applying good faith without a framework frustrates this task.<sup>105</sup>

Moreover, the *Bohatch* result is highly questionable. The duty of good faith should prevent partners from using expulsion to retaliate against another partner for seeking to uncover and address abuse within the partnership. If courts permit expulsion based on retaliation, it is hard to see what the duty of good faith actually forbids. To apply the doctrine in this manner seems to render it virtually meaningless.<sup>106</sup>

*Bohatch* also runs counter to public policy. Self-policing is highly prized in the legal profession – so much so that the attorney professional conduct rules actually require that attorneys report unethical behavior.<sup>107</sup> Yet, *Bohatch* creates exactly the opposite incentive by permitting partners to use expulsion as retaliation for whistleblowing.<sup>108</sup> Now, partners must decide whether to risk their jobs by reporting the conduct or to remain silent and risk violating the attorney conduct rules. When faced

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<sup>102</sup> *Bohatch*, 977 S.W.2d at 544-45.

<sup>103</sup> *Nosal*, 664 N.E.2d at 246.

<sup>104</sup> *Bohatch*, 977 S.W.2d at 547.

<sup>105</sup> Case-by-case analysis of good faith has attracted debate in the contracts arena as well. One commentator argued that it is from this approach that the doctrine garners its definition. In an influential article regarding this topic, Professor Robert S. Summers contends that good faith “is best understood as an ‘excluder’ – it is a phrase which has no general meaning or meanings of its own, but which serves to exclude many heterogeneous forms of bad faith.” Robert S. Summers, “Good Faith” in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 196 (1968) (footnote omitted). This analysis has spurned much controversy. See, e.g., Michael G. Bridge, *Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?*, 9 CAN. BUS. L. J. 385, 398 (1984) (arguing that Summers’s theory “seems tantamount to saying that the good faith duty is breached whenever a judge decides that it has been breached”).

<sup>106</sup> Others have also questioned the wisdom of the *Bohatch* decision. See, e.g., Margaret Kline Kirkpatrick, Comment, *Partners Dumping Partners: Business Before Ethics in Bohatch v. Butler & Binion*, 83 MINN. L. REV. 1767 (1999).

<sup>107</sup> See, e.g., MODEL RULES OF PROF’L CONDUCT R. 8.3 (2002).

<sup>108</sup> See *Bohatch*, 977 S.W.2d at 561 (Spector, J., dissenting) (arguing that “retaliation against a partner who tries in good faith to correct or report perceived misconduct virtually assures that others will not take these appropriate steps in the future”).



with this choice, many lawyers will probably remain silent. Since the *Bohatch* rule makes the prospect of reporting suspected misconduct much more undesirable, it undermines the policy goal of having lawyers monitor themselves.

As the varied results and methodologies of the above cases illustrate, the law of partner expulsion is unsettled. The statutes that govern much of partnership law have left this region alone, providing that expulsion is permissible if provided for in the partnership agreement and executed in good faith.<sup>109</sup> Where courts differ is in how good faith is conceptualized and applied. Good faith, by its very nature, is a tricky phrase to define, but some courts have attempted to give this amorphous doctrine some shape in the expulsion context. One interpretation holds that good faith generally requires that expulsion be justified by legitimate business reasons;<sup>110</sup> another reading is nearly the opposite – that good faith only prevents economic predation.<sup>111</sup> Other cases have not been so bold. Instead, they have simply deemed a particular action to either violate or comply with the duty of good faith without giving an explanation as to how their results fit into a systematic analysis of the doctrine.<sup>112</sup>

Each of these approaches has its own flaws. The means of analysis explored below addresses these shortcomings with a contract law framework that incorporates partnership law concepts.

#### IV. FORGONE OPPORTUNITY ANALYSIS

The difficult issue that arises in partner expulsions is whether the ousted partner was let go in good faith. This inquiry has proven so troublesome because there is no well-accepted framework for analyzing good faith in the partnership context.<sup>113</sup> Traditional partnership law provides that certain actions permissible in an arms-length relationship are not appropriate when partners are dealing with each other;<sup>114</sup> it just does not explain

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<sup>109</sup> See, e.g., UNIF. P'SHIP ACT § 31(d) (1914); REVISED UNIF. P'SHIP ACT § 601(3) (1997).

<sup>110</sup> See, e.g., *Gigax v. Repka*, 615 N.E.2d 644, 650 (Ohio Ct. App. 1992).

<sup>111</sup> See, e.g., *Holman v. Coie*, 522 P.2d 515, 523 (Wash. Ct. App. 1974).

<sup>112</sup> See, e.g., *Winston & Strawn v. Nosal*, 644 N.E.2d 239, 246 (Ill. App. Ct. 1996); *Bohatch v. Butler & Binion*, 977 S.W.2d 543, 547 (Tex. 1998).

<sup>113</sup> See *Dalley*, *supra* note 16, at 183 (“Unfortunately, neither litigants nor courts show a clear understanding of how fiduciary duties and the implied covenant of good faith apply to partner expulsions. Moreover, many courts are uncertain about the differences between fiduciary duty and good faith.”).

<sup>114</sup> See REVISED UNIF. P'SHIP ACT § 404 (1997).

which activities these are.<sup>115</sup>

Good faith has been explored more thoroughly in the contracts arena, where “forgone opportunity analysis” has been posited as a means of analyzing whether one party’s performance pursuant to a contract meets this standard.<sup>116</sup> Issues of good faith performance arise in connection with contracts that give one party discretion.<sup>117</sup> For instance, in a requirements contract, the buyer agrees to purchase all it requires of a particular product from a certain seller. This type of contract gives the buyer discretion over how much to purchase. Contract law requires that this decision be made in good faith.<sup>118</sup> In order to analyze whether this duty has been met, forgone opportunity analysis considers whether the discretion-exercising party used its discretion “to recapture opportunities forgone upon contracting.”<sup>119</sup>

The approach is two-pronged. The first prong asks what the discretion-exercising party’s intent was when acting.<sup>120</sup> This is a subjective inquiry into why the party actually exercised discretion in the manner that he or she did.<sup>121</sup> The second prong then asks whether acting for this purpose was an opportunity forgone at the time of the contract.<sup>122</sup> This analysis is objective, “focusing on the expectations of reasonable persons in the position of the dependent parties.”<sup>123</sup> If a dependent party—one subject to the other’s use of discretion—reasonably believed that the other party gave up the freedom to act for a certain purpose, then acting for that purpose is a forgone opportunity, and therefore bad faith.<sup>124</sup>

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<sup>115</sup>See, e.g., UNIF. P’SHIP ACT § 31(d) (1914); REVISED UNIF. P’SHIP ACT § 601(3) (1997).

<sup>116</sup>See, e.g., Burton, *supra* note 8 *passim*.

<sup>117</sup>See Burton, *supra* note 8, at 369.

<sup>118</sup>See U.C.C. § 1-304 (2003); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

<sup>119</sup>See Burton, *supra* note 8, at 373.

<sup>120</sup>Burton, *supra* note 8, at 391.

<sup>121</sup>See Burton, *supra* note 8, at 391.

<sup>122</sup>Burton, *supra* note 8, at 390-91.

<sup>123</sup>Burton, *supra* note 8, at 391.

<sup>124</sup>Notice that the inquiry focuses on expectations at the time of the agreement. See Burton, *supra* note 8, at 391. Arguably, expectations evolve over time, and it is the dependent party’s viewpoint regarding the parameters of the other party’s discretion when that discretion was exercised that should matter. This, however, would not be a conceptually sound approach. Expectations at the time of the parties’ agreement are evidence regarding what the parties intended in their contract. In a way, therefore, the court is looking to expectations in order to imply terms into the agreement. It would not be fair to hold the discretion-

The requirements contract situation illustrates this test. In one case, a buyer was involved in the business of manufacturing a certain type of fertilizer for resale.<sup>125</sup> The buyer contracted with the seller to buy all it required of one of the raw materials that went into the finished product for a fixed price over the five year term of the contract.<sup>126</sup> When fluctuations in the market price of the fertilizer's raw materials rendered this business unprofitable, the buyer temporarily gave it up.<sup>127</sup> Then, the buyer simply began purchasing already-manufactured fertilizer and reselling it to customers.<sup>128</sup> The buyer alleged that this conduct was proper because, over the period when the buyer did not purchase any of the seller's products, the buyer was still purchasing the business's requirements – zero.<sup>129</sup>

The court disagreed, finding that the contract did not allow discretion to be exercised in this manner.<sup>130</sup> This result is consistent with forgone opportunity analysis. Under this approach, the first step is to determine the buyer's expectations.<sup>131</sup> Here, the buyer stopped purchasing when market fluctuations involving the seller's product, as well as other raw materials used in the buyer's manufacturing process, made the buyer's method of doing business unprofitable.<sup>132</sup> Since purchasing under the contract with the seller was not advantageous, the buyer found an alternative.<sup>133</sup>

The next question is whether the opportunity to completely alter the business in order to avoid unfavorable market fluctuations was given up in the contract.<sup>134</sup> This is determined by looking at the seller's reasonable expectations.<sup>135</sup> Here, it appears that the seller would expect that the buyer had given up this opportunity. The seller would anticipate the buyer altering the

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exercising party to the recently formed expectations of the dependent party, because these expectations would not serve to interpret an agreement among the parties.

<sup>125</sup> See *Loudenback Fertilizer Co. v. Tenn. Phosphate Co.*, 121 F. 298, 299 (6th Cir. 1903). Burton uses this case to demonstrate forgone opportunity analysis in his article on the topic. Burton, *supra* note 8, at 395-96.

<sup>126</sup> *Loudenback*, 121 F. at 298-99.

<sup>127</sup> *Id.* at 299.

<sup>128</sup> *Id.*

<sup>129</sup> *Id.* at 301.

<sup>130</sup> *Id.* at 302-03.

<sup>131</sup> See Burton, *supra* note 8, at 391.

<sup>132</sup> *Loudenback*, 121 F. at 302.

<sup>133</sup> *Loudenback*, 121 F. at 302.

<sup>134</sup> See Burton, *supra* note 8, at 390-91.

<sup>135</sup> See Burton, *supra* note 8, at 390-91.

amount purchased as the needs of its business dictated in the ordinary course; however, the seller would not expect that the business would be totally abandoned if it became commercially disadvantageous.<sup>136</sup> Thus, the buyer's exercise of discretion in this manner would constitute bad faith.

The same analysis can be applied in the partner expulsion context. The partnership agreement can be viewed as a contract that grants discretion to one of the parties. Just as a buyer in a requirements contract can decide how much to buy, the members of a partnership can decide when and how to expel.<sup>137</sup> Like the buyer's purchasing decisions, the partnership's expulsion-related decisions must be made in good faith.<sup>138</sup>

These partnership decisions have been challenged on both procedural and substantive grounds. As to the former, plaintiffs have claimed good faith violations when they were not provided with protections reminiscent of due-process, such as the opportunity to be heard before ouster.<sup>139</sup> Challenges with respect to the latter, on the other hand, focus on the argument that the expulsion decision was made for an improper reason.<sup>140</sup> Forgone opportunity analysis can equitably handle both challenges. According to this methodology, the first step is to look at the motives in connection with the expulsion, and the next is to determine whether acting for those purposes was an opportunity forgone in the partnership agreement.

#### A. First Element – Subjective Intent of the Expelling Partners

In analyzing the first element, courts should look at evidence relevant to determining the rationale for a particular exercise of discretion relating to expulsion. In *Nosal*, for instance, the court considered much evidence bearing on whether the plaintiff was ousted for business reasons (as the partnership claimed) or to prevent him from uncovering wrongful conduct (the ousted part-

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<sup>136</sup> *Loudenback*, 121 F. at 303.

<sup>137</sup> UNIF. P'SHIP ACT § 31(d) (1914) ("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 . . ."); REVISED UNIF. P'SHIP ACT § 601(3) (1997).

<sup>138</sup> UNIF. P'SHIP ACT § 31(d) (1914); REVISED UNIF. P'SHIP ACT § 404(d) (1997) ("A partner shall 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.")

<sup>139</sup> *See, e.g., Holman v. Coie*, 522 P.2d 515, 521 (Wash. Ct. App. 1974).

<sup>140</sup> *See, e.g., Gigax v. Repka*, 615 N.E.2d 644, 650 (Ohio Ct. App. 1992).

ner's assertion).<sup>141</sup>

The court cited little that supported the law firm's claim, but found much evidence to suggest Nosal was let go for the reasons he described. In the months preceding expulsion, the other partners praised Nosal's work-product: they informed him that his "contribution to the firm had exceeded projections" and awarded him "increased compensation."<sup>142</sup> All of this suggests that a failure to contribute to the value of the business was not to blame for his ejection. On the other hand, the alternate theory – that his expulsion resulted from his repeated efforts to obtain information about the firm's finances in order to uncover suspected fraud – looked especially compelling in light of the following: Nosal was expelled immediately after threatening the partner he suspected of fraud with a lawsuit related to his rights to inspect firm books.<sup>143</sup> That partner was "instrumental" in orchestrating Nosal's expulsion, and subsequent review revealed a "fraudulent billing scheme" that Nosal would have likely uncovered if he had not been denied proper access to the books.<sup>144</sup> This type of evidence is exactly what courts should look to when scrutinizing the reasoning behind a particular expulsion.

Moreover, the analysis should still focus on subjective intent even if the ousted partner is not alleging bad faith for why he was expelled, but for how. The key question here is what motivated the partnership to overlook procedural protections. For instance, in *VGS, Inc. v. Castiel*, two members of a limited liability company conspired to reduce the ownership percentage of the third member (and thereby oust this person from control) by voting to merge the LLC into a corporation.<sup>145</sup> In order for their plan to work, they had to do so without giving the remaining member notice of the transaction.<sup>146</sup> The court found that in this situation, the failure to provide notice was bad faith.<sup>147</sup> Under the applicable LLC statute and the company's operating agreement, notice was not required.<sup>148</sup> However, the court found this irrelevant because in this situation, failure to give notice was for the improper purpose of surreptitiously depriving a co-owner of

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<sup>141</sup> *Winston & Strawn v. Nosal*, 664 N.E.2d 239, 243-44 (Ill. App. Ct. 1996).

<sup>142</sup> *Id.* at 244.

<sup>143</sup> *Id.* at 243-44.

<sup>144</sup> *Id.* at 245-46.

<sup>145</sup> *VGS, Inc. v. Castiel*, No. C.A. 17995, 2000 WL 1277372, at \*1 (Del. Ch. Aug. 31, 2000).

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> *Id.* at \*4.

his rightful share.<sup>149</sup> As this case illustrates, the motive for denying procedural protections is highly probative of good faith.<sup>150</sup> Once the motivations have been uncovered, the next question is whether actions so motivated were within the reasonable expectations of the ousted partner.

#### B. Second Element – Reasonable Expectations of the Expelled Partner

As discussed above, plaintiffs challenge expulsion based on substantive and procedural grounds. When the challenge is substantive, the first element resolves the question of what the grounds for expulsion actually were. Once this question is answered, the inquiry becomes whether using expulsion for this purpose is an attempt to recapture a forgone opportunity. This is the case if it appears that the expelled partner would not have reasonably expected the partners to oust him for the reason uncovered above.

Different reasons for expulsions warrant different analyses. If expulsion is found to be undertaken for a purpose that violates public policy, it should automatically be viewed as contrary to the ousted partner's expectations. But if the motivation cannot be characterized as such, then there are many pieces of evidence to which a court can turn in order to determine how to classify the partnership's actions.

##### 1. Expulsion in Violation of Public Policy

Based on public policy, there are certain reasons an employee cannot be terminated. For example, federal statutes protect an employee from firing based on race, gender or religion.<sup>151</sup> These laws have repeatedly been found inapplicable to partner expulsions, however, because the statutes literally only extend to

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<sup>149</sup> *Id.*

<sup>150</sup> *Id.* A partner may allege that the failure to provide procedural safeguards was in itself bad faith, no matter the purpose. This, however, is not an argument that the partnership inappropriately exercised its discretion; rather, the allegation is that good faith demands that there be no discretion. Since purpose is not at issue, the proper way to analyze such a claim would be to focus on the second element. The question becomes whether the ability to forego procedures was itself an opportunity forgone at the time of the agreement. The same evidence discussed *infra*, Part IV. B. Second Element – Reasonable Expectations of the Expelled Partner, would weigh on this inquiry.

<sup>151</sup> See Title VII of the Civil Rights Act of 1964, 42 U.S.C.A. § 2000e-2(a)(1) (West 2003) (prohibiting discrimination based on race, color, religion, sex, or national origin).

“employees.”<sup>152</sup> Though this may be a technically accurate understanding of these statutes, similar protection should be given to partners by reading these safeguards into the duty of good faith.<sup>153</sup>

Basing expulsion on such grounds can be conceived of as attempts to recapture forgone opportunities. When entering a partnership, it is reasonable for partners to believe that they will not be expelled for reasons that would violate public policy. For instance, partners normally do not enter into a partnership agreement with the expectation that they could be expelled because of their race or gender. Since expulsion based on these grounds appears to be outside reasonable expectations, it is a forfeited opportunity.

It is arguable, however, that explicit language in the partnership agreement could defeat the expectation of receiving protections akin to those offered by employee-protection legislation. RUPA, for instance, specifically allows partners to agree on the scope of the duty of good faith.<sup>154</sup> Conceivably, a partner could be asked to specify that the duty of good faith does not encompass the protections of federal or state anti-discrimination laws. In the presence of such language, it would be unreasonable for a partner to believe expulsion could not be used for discriminatory purposes. Therefore, such use would not be a forgone opportunity.

Nevertheless, this type of language should be unenforceable. It is a well-accepted contract law principle that agreements that violate public policy are void.<sup>155</sup> An expulsion provision that seeks to counter anti-discrimination statutes or other employment-related laws should be ignored pursuant to this doctrine.

Codes that prevent termination for public policy reasons are designed to safeguard individuals against unfair and offensive treatment. Partners should be afforded this protection by viewing expulsion in violation of these statutes as bad faith. This should be the result irrespective of the language in the parties' partnership agreement.

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<sup>152</sup> See *Wheeler v. Hurdman*, 825 F.2d 257, 277 (10th Cir. 1987) (holding that “bona fide general partners are not employees under the Anti-discrimination Acts”). Note that if the partner alleging discrimination looks more like an employee than a partner, then anti-discrimination protections may apply. See, e.g., *Simpson v. Ernst & Young*, 100 F.3d 436, 443-44 (6th Cir. 1996).

<sup>153</sup> See Baynes, *supra* note 76, at 831.

<sup>154</sup> REVISED UNIF. P'SHIP ACT § 103(5) (1997).

<sup>155</sup> See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 178 (1981).

## 2. Expulsions Based on Other Rationales

If the expulsion comports with public policy, then the court must delve deeper into whether the expulsion was in line with the ousted partner's reasonable expectations under the facts and circumstances of the particular case. Much could shed light on this inquiry.

The first item to look at is the contract itself. Its language can provide great insight into partner expectations. For instance, if a contract specified that expulsion had to be "for-cause," a partner likely would not expect to be expelled, unless the motivation for taking this action was particularly compelling.

On the other hand, if an agreement specified the opposite – that no showing of good cause is required – then it appears the partnership gave itself a great degree of freedom in deciding when to expel. Under such a provision, for instance, partners likely could not complain if they were expelled to increase the profits-per-partner of the remaining partners – despite their own excellent performance – because it seems this is precisely the flexibility the partnership sought to achieve when crafting the expulsion provision.

It is rare, however, for an agreement to contain specific language regarding cause as in the examples above; extremely concise provisions are more common. For example, an agreement may state simply that "a vote of two-thirds of the partnership is sufficient to expel a partner." In the face of provisions such as this, which are silent as to acceptable rationales for expulsion, courts must rely on evidence outside the agreement in order to determine which motivations the expelled partner would expect.

One item to look at is whether other partners made any oral assurances to this person. Take, for example, an individual who wishes to become a partner in a large law firm that is unwilling to amend its partnership agreement to satisfy a would-be member. In this situation, it is easy to imagine that an oral assurance would be made if this prospective partner expressed concern about an ambiguous expulsion provision. A senior partner may, for instance, state that expulsion is only used in the case of severe misconduct. Such a declaration would justifiably affect the expectations of this partnership candidate.



Similarly, the past practice of the partnership may be probative of expectations. For example, in *Hogan v. Morton*, the court looked at whether the expulsion of a law partner, Paul Hogan, for having an affair with an associate was legitimate.<sup>156</sup> In examining this question, the court considered Hogan's assertion that in his ten years of experience with the firm, expulsion had only been used for matters relating to a partner's ability to practice law.<sup>157</sup> This experience very likely influenced the partner's expectations about the reasons that could be used to justify his own expulsion.

Finally, courts should consider the formal and informal structure of the partnership. The paradigmatic partnership is one in which there are only a few partners, and each of them share equally in economic gains and losses, as well as management responsibility. In this scenario, the parties would likely have high expectations of one another – and these would likely extend to expulsion. For instance, a partner in this type of arrangement would likely expect expulsion to only be used as a remedy for egregious conduct – and only as a last resort. Each partner likely has given up the ability to unceremoniously cut ties.

However, not all partnerships are structured like this. Large law firms, for instance, bear little resemblance to the prototype presented above: there may be hundreds of partners; management may be the task of only a few; and profits may be allocated unequally among the members. In such a case, partners would seem to have fewer expectations of their fellow partners. In the expulsion context, therefore, it would appear that the partnership would have much greater freedom when exercising its discretion; a reason for expulsion that would be unacceptable in the paradigmatic case may well fall within the expectations of a partner at a firm with a more hierarchical structure.

The formal structure of the firm gives insight into what partners may expect as does the informal structure – or the firm's culture. It may be that a partnership structure deviates from the paradigm, but nevertheless the partners' relationships with each other are closer to those of a small firm marked by trust and cooperation. Here, the partners would expect a great deal from each other and, therefore, the ability to use expulsion would be circumscribed.<sup>158</sup>

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<sup>156</sup> *Hogan v. Morton*, No. 03A01-9206-CH-00214, 1993 WL 64220, at \*1 n.1 (Tenn. Ct. App. March 10, 1993).

<sup>157</sup> *Id.* at \*5-6.

<sup>158</sup> Much of the evidence about the informal structure of the firm may relate to conduct after the expulsion provision was agreed to. This does not mean,

The above is a non-exclusive list of evidence bearing on whether expulsion in pursuit of a particular purpose was a forgone opportunity. Though each of the above considerations is relevant, they are not equally straightforward to apply. Ideally, evidence would directly show whether the expelled partner would have reasonably anticipated ouster for the reasons exposed. For example, if a partner was expelled because he was less profitable than his peers, such action would clearly be bad faith in light of evidence that the expelled partner had been told that expulsion would only be used in cases of serious misconduct.

But such evidence will probably be difficult to uncover. It is more likely that a court will be forced to rely on conduct showing the partner's expectations more generally, and from that the court will render its judgment about whether the expulsion at issue was foreseeable. For instance, when considering the scenario in which a partner is expelled for being less profitable, a court may encounter evidence that the expelling partnership has generally been marked by a high degree of trust and loyalty. This information does not directly tell the court whether this partner should have expected expulsion for lackluster results; however, it does at least imply as much. The court must seek out and carefully consider such evidence. If after looking at all the relevant evidence, it appears that the ousted partner would reasonably have expected that the partnership had given up the right to expel for the purpose that it did, then the expulsion is in bad faith.

The same type of evidence is also relevant when analyzing whether the partnership denied procedural protections in pursuit of a forgone opportunity. Above, the focus was on the motivation for the expulsion itself; here, it is on the purpose for denying procedural safeguards – specifically, whether acting for such purpose was outside the ousted partner's expectations.

Each piece of evidence discussed above is potentially relevant to determining these expectations. The contract itself, for example, may be quite probative. In the *VGS* case, two members of an LLC avoided notifying the third member of a pending transaction so that they could use it to oust him from control of the company.<sup>159</sup> Here, the terms of the LLC agreement indicated that this action was outside the parties' expectations: the contractual language was clearly selected to guarantee control to the

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however, that it has no bearing on the focus of the inquiry – the expectations of the ousted partner when the provision was drafted. For instance, if a partnership is highly collegial, it is likely that this is what the parties envisioned at formation.

<sup>159</sup> *VGS, Inc. v. Castiel*, No. C.A. 17995, 2000 WL 1277372, at \*1 (Del. Ch. Aug. 31, 2000).

ousted member.<sup>160</sup> Thus, control was an opportunity the minority shareholders had to forego at the time they entered the business; their attempt to appropriate such by ignoring proper procedures was therefore in bad faith.

### C. Summary

Forgone opportunity analysis can be used to address both substantive and procedural challenges to expulsion. The first step in each case is to determine the expelling partners' motives. With respect to substantive challenges, the focus is on the motivation for the decision to expel; as to procedural complaints, it is the partnership's reason for denying procedural safeguards.

The second step is to decide if acting for the purpose determined above was a forgone opportunity. This depends on the affected partner's expectations: if this individual would have reasonably expected that acting with such motivation was a freedom given up when the partnership agreement was executed, then the partnership has acted to recapture a forgone opportunity, and in doing so, has breached its duty of good faith.

Relevant evidence as to the ousted partner's expectations can come from many sources, including, *inter alia*, the contract itself, the past practice of the partnership, and the firm's structure.

### D. Advantages of Forgone Opportunity Analysis

Forgone opportunity analysis is a step forward from the current state of the law. As discussed in Part III, the law in this area has evolved along three trajectories. One approach focuses on whether good faith requires that expulsions be "for cause." It appears some cases would always impose this requirement, though a narrower version of this rule has been suggested, which requires cause only if fair and consistent with the partners' intent.<sup>161</sup>

Focusing on cause is not the most direct means of analyzing good faith. When looking at this doctrine, the focus should be on determining the expelled partner's thinking about the particular motivation behind his or her expulsion. Analyzing the partners' views about cause may lead to useful insights regarding this inquiry, but it is only one piece of evidence that bears upon it. Forgone opportunity analysis, by directly examining the relevant question, is a more comprehensive framework.

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<sup>160</sup> *Id.*

<sup>161</sup> See *supra* Part III. A. Legitimate Business Purpose.

Another approach has been to find the duty of good faith applicable only to situations where the expelling partners acted for economic self-gain. This approach is under-inclusive in that it leaves much that could constitute bad faith, such as racial discrimination, outside of the definition.<sup>162</sup> The framework posed in this article does not suffer from this problem; it is designed to uncover all forms of violative conduct.

Finally, some courts have applied the duty of good faith directly to the facts at issue, reaching their holdings without opining on the general nature of the doctrine. This approach is lacking because it does not advance the development of meaningful precedent on the topic.<sup>163</sup>

It can be argued that forgone opportunity analysis suffers from the same flaw. Because this framework relies on a highly contextual inquiry, rather than set rules, it may not lead to perfectly consistent case law. The same flexibility, however, that allows this approach to proficiently address the issue of good faith, is what may prevent it from always being predictable. Therefore, it is a necessary evil. Moreover, because forgone opportunity analysis provides a framework for review, the results should be more consistent than with the case-by-case approach, which leaves good faith to judicial discretion.

The analysis presented here, therefore, improves on the current law. It also presents a means of analysis that treats the parties equitably. The partnership has wide latitude to expel. Its only restraint is the affected partner's reasonable expectations. If the partnership is concerned about these expectations, it can protect itself by specifically providing for how and when expulsion may be used (within the confines of public policy). The expelled partner, on the other hand, is assured that expulsion will only be permitted if in line with reasonable expectations. Thus, this framework makes sure that this individual will not be caught off guard.

## V. CONCLUSION

Current partner expulsion analyses are inadequate. A better approach borrows from contract law theory, namely forgone opportunity analysis. This framework focuses on whether the expelling partners were acting to recapture an opportunity given

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<sup>162</sup> See *supra* Part III. B. *Holman* and its Progeny: Economic Self-Gain and Contractual Plain Meaning.

<sup>163</sup> See *supra* Part III. B. *Holman* and its Progeny: Economic Self-Gain and Contractual Plain Meaning.

up at the time the partnership was formed. If this was the case, then they have conducted themselves in bad faith. Considering ouster from this perspective provides fair treatment for both sides of an expulsion dispute.