

**Only "the Punctilio" if I Say So:
How Contractual Limitations on Fiduciary Duties Deny Protection to
Victims of Oppressive Freeze-Outs within Private Business Entities**

Mary-Hunter Morris

Justice Cardozo first famously formulated the unassailable core of fiduciary duties in *Meinhard v. Salmon*:

“Joint adventurers, like co-partners, owe to one another ... the duty of the finest loyalty ... something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive is the standard of behavior.”¹

In the wake of the rise of the contractarian paradigm – championed by Delaware corporate law’s juggernaut of contractual excess – Cardozo’s vision of an obdurate fidelity provided by strict and immutable fiduciary duties appears to have met its greatest challenge. The scope of the fiduciary duty has been gradually eroded since Cardozo’s seminal statement of its predominate authority. It has suffered trivialization by the business judgment rule and marginalization by some states’ statutes that oppressively constrict the fiduciary definition or liberally allow members to “opt-out” of the fiduciary duty entirely.²

Evidence of the persistent oppression of those holding minority interests in all classes of private business entities has led many scholars to suggest that our facile discount of the fiduciary

1. *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y.1928).

2. See Eric Talley, *Taking the “I” Out of Team”: Intra-Firm Monitoring and the Content of Fiduciary Duties*, 24 J. CORP. L. 1001, 1008-09 (1999) (“The powerful ‘business judgment rule’ essentially acts as a legal presumption that corporate fiduciaries have exercised requisite skill in carrying out their appointed duties—a presumption that can be overcome only by a showing of managerial recklessness, fraud, or waste. Additionally, many states now have so-called ‘exoneration statutes,’ which either permit (or sometimes mandate) liability limits and/or indemnification for a fiduciary’s violation of her duty of care”).

duty may have been rash.³ They argue that the constraints provided by contract law on majority misconduct are not powerful enough to ensure that minority interests are protected, and a restoration of strict fiduciary duties is a necessary and essential tool to curtail continued misuse of majority power for opportunistic means.⁴ Moreover, courts in numerous jurisdictions have repeatedly hearkened back to the fiduciary principles suggesting- at least rhetorically- that rumors of the death of the fiduciary duty “have been greatly exaggerated.”⁵ All of these factors have culminated in a battle of ideologies concerning the necessity for heightened standards of fiduciary duties within private business entities, one which “pits the interest in the freedom of contract against the need to both curtail abusive conduct and foster accountability.”⁶

Amidst these developments that force the reevaluation of the role of the fiduciary duty and its ability to survive the contractarian regime, many jurisdictions have built one durable bastion for adherence to Cardozo’s stringent fiduciary prescription within the context of close corporations. Here the doctrine of oppression was bred and cultivated, leading to the formulation of a number of protections for minority shareholders that are implemented by Courts as

3. For a comprehensive review of the extent to which courts have allowed the corrosion of fiduciary duties, including a conclusion that the fiduciary duty should not be so readily disregarded, *see* Michael Haynes, *Partners Owe to One Another a Duty of the Finest Loyalty... Or do They? An Analysis of the Extent to Which Partners May Limit Their Duty of Loyalty to One Another*, 37 TEX. TECH L. REV. 433 (2005); *see also* Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom with the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC*, 152 U. PA. L. REV. 1609, 1613 (2004) (“The primary message of this Article is that the courts are central to ... balancing the interest in contractual freedom with the need to constrain opportunistic and deceptive conduct through the development of a minimum mandatory core of acceptable business conduct”).

4. *See, e.g.,* Miller, *supra* note 3, at 1654 (arguing that broad fiduciary duties are “preferable to a narrower test of entire fairness or a contractually oriented standard of good faith because it better reflects society’s norms of ethical conduct, may be more effective in combating subtle freeze-out schemes, and does not rest on the assumption that the parties’ relationship is governed by a highly negotiated and well-conceived contract”).

5. *See, e.g.,* Talley, *supra* note 2, at n. 32, noting that over 900 federal and state cases can be found in a Lexis search in which Cardozo’s description of fiduciary duties in *Meinhard* is directly quoted.

6. Miller, *supra* note 3, at 1627.

extensions of or strict adherences to the rule of fiduciary duty. Although the oppression doctrine has largely developed confined within the context of the close corporation, oppression has been a blight on all categories of business, and “attempts to deal with [it] by statute and judicial decision are as old as corporate law.”⁷

Here I address the continued need for mandatory fiduciary duties within all categories of private business entities, calling for a restitution of Cardozo’s paradigmatic fiduciary duties. I will first survey the utility of fiduciary principles when used to confound the infamous “freeze-out” within the private business entity. I will then examine how that utility will be compromised by allowing contractual constriction or elimination of fiduciary duties.

Part One will define the clash of contractually defied duties with mandatory fiduciary duties relative to the greater debate between the over-arching contractarian and social responsibility theories of the corporation. Part Two will discuss the development and effects of the oppression doctrine within the close corporate context. Here the tools implemented by many jurisdictions to combat such oppression will be described and examined. In Part Three, freeze-outs and oppression within partnerships will be examined, their judicial responses evaluated. Here, I offer a case study of oppression and freeze-outs within law firm partnerships because, as lawyers are often used as the exemplars of contractual knowledge, oppression of minority interests within law firms should serve as an especially potent expression of the deficiencies of the contract and the continued need for application of mandatory fiduciary duties to combat oppression. Part Four will discuss the implications of the fiduciary by contract debate within

7. John H. Matheson and R. Kevin Maler, *A Simple Statutory Solution to Minority Oppression in the Closely Held Business*, 91 MINN. L. REV. 657, 658 (2007).

the hybridized limited liability company (LLC). I will culminate in an appeal for the imposition of strict fiduciary duties within all private business entities.

Part 1: Over-arching Theories Characterizing the Debate

“The superior person understands rightness; the inferior person understands profit.”
- Confucius

Much of the contention regarding the extent to which businessmen should be able to contractually modify or voluntarily opt-out of fiduciary duties is rooted in the arguer’s belief about the very foundation or purpose of the business entity.⁸ Many of our judges today, for example, studied a corporate law permeated with the “concession theory,” which theorized that the corporation was an artificial thing, having no life until granted such by the sovereign’s presentation of a corporate charter.⁹ It must have been a true struggle for them to come to terms with today’s pervading conception of the corporation as a “nexus of contracts” in which those who voluntarily partake in a business entity are given broad discretion to create and determine almost every aspect of their enterprise.¹⁰ This contractarian view has focused on the economic relationships between businessmen and shareholders, advocating that freedom of contract is valuable in providing businessmen with the ability to “strike their own business deals.”¹¹ The

8. See generally Cynthia S. Grandfield, *The Reasonable Expectations of Minority Shareholders in Closely Held Corporations: The Morality of Small Business*, 14 DEPAUL BUS. L.J. 381, 396 (2002) (offering a concise overview of how disparate theories of the corporation clash with one another).

9. See Robert W. Hillman, *The Bargaining in the Firm: Partnership Law, Corporate Law, and Private Ordering Within Closely-Held Business Associations*, 2005 U. ILL. L. REV. 171, 176 (2005).

10. For use of the “nexus of contracts” language, see, e.g., Thomas J. Bamonte, *Should the Illinois Courts Care about Corporate Deadlock?*, 29 LOY. U. CHI. L.J. 625 (1998) (“[A] corporation is a ‘nexus of contracts.’ In other words, the business enterprise is the product of a large number of relationships between capital suppliers and managers, employees and managers, the enterprise and its customers, and the like”).

11. Sandra K. Miller, *supra* note 3, at 1617.

role of the Courts is largely to stay out of the way of the businessmen.¹² After all, Judges are not in the business of business, and any judicial interference or attempt to assess “what the parties would have determined” is likely to be skewed by a misinterpretation of the economic goals of the business entity, stifling an enterpriser’s ability to freely contract in the future.¹³ An “implicit value judgment underlying [the] contractarian view is that governmental policies based on interference and protectionism are inherently negative and should yield to the freedom of parties to contract on their own behalf.”¹⁴

In the wake of growing awareness and concern about corruption within corporation, industry’s detrimental effects on the environment, and the societal plague of poverty, another old theory of corporations- the social responsibility theory – is gaining new momentum. This theory also focuses on relationships among those within a business entity, but it looks beyond their mere economic or market-based alliances to examine their moral and professional responsibilities to each other. Moreover, the theory promotes expanding the examination of relationships to assay the effects that a business has on all of society. This theory advocates a more active role of the courts through judicial intervention. Judges are, after all, in the business of justice, and although businesses are obviously primarily in pursuit of economic gain, it is in the greater interest of all participants in business – and society as a whole – for our Courts to make sure that that economic gain is not had at the expense of equity and fairness. Ultimately, as

12. See, e.g., Sandra K. Miller, *supra* note 3, at 1650 (arguing that the “critical role of the judiciary and the need for flexible judicial concepts and equitable doctrines” evident in emergent case law of limited liability business entities is “virtually lost, conceptually, in the contractarian model”).

13. See J. Dennis Hynes, *The Revised Uniform Partnership Act: Some Comments on the Latest Draft of RUPA*, 19 FLA. ST. U. L. REV. 727, 752 (1992) (“The parties ... should be the ones who control the boundaries of their relationship, not a court standing outside the situation and second guessing actions that affect only members of that relationship”).

14. Miller, *supra* note 3, at 1619.

noted by London School of Economics Professor C.A.E. Goodhart, “For the law to ignore questions of equity is rather like asking Mrs. Lincoln whether she otherwise liked the play.”¹⁵

To understand the correlations and implications of minority oppression, negotiations through contract, and fiduciary duties in all forms of business enterprise, it is crucial to first locate these doctrines within the over-arching contractarian and social responsibility theories of the business entity.

A. The Contractarian Theory of the Business Entity

“When morality comes up against profit, it is seldom that profit loses.”
-Congresswoman Shirley Chisholm

The view of the business entity as a “nexus of contracts” was conceptually born as a result of the avid acceptance that the law and economics theory found within business law.¹⁶ This theory proposes that businessmen best know business, and as such they should be allowed broad discretion in determining the best and most workable rules for their own enterprise. Mandatory rules should be discouraged in order to facilitate the parties in exercising broad control over every aspect of their business and to contractually define the nature of their business in any way that they deem appropriate.¹⁷ The proper role of the state as perceived by

15. C.A.E. Goodhart, *Economics and the Law: Too Much One-Way Traffic?*, 60 MOD. L. REV. 1, 12 (1997).

16. See Douglas M. Branson, *Assault on Another Citadel: Attempts to Curtail the Fiduciary Standard of Loyalty Applicable to Corporate Directors*, 57 FORDHAM L. REV. 375, 395 n. 95 (describing the firm as “nothing more than a ‘nexus’ or ‘web’ ‘of contracts’ among providers of capital, managers, lenders, labor, suppliers and consumers”).

17. See Miller, *supra* note 3, at 1613 (“external monitoring does not appear to fit within the contractarian equation that emphasizes the supremacy of the private contract and the importance of reducing transaction costs through lack of external interference”); see also J. Dennis Hynes, *supra* note 13, at 751-52 (“Absent gross overreaching, duress, or fraud, the parties ought to be able to define the limits of their relationship in the terms they wish”).

contractarians is dual: “first, to provide an appropriate mechanism for bargain enforcement; and, secondly, to provide a framework within which bargaining is made more efficient.”¹⁸

As the mandatory enforcement of the fiduciary duty is not always in accordance with the contractarian objective of utmost efficiency, contractarians are generally opposed to the imposition of fiduciary duties outside of the default statutory context.¹⁹ They do not perceive fiduciary duties as a necessary component of the business entity, but rather “as a product of a hypothetical bargain.”²⁰ Contractarians believe that the “fiduciary paradigm” is grossly inefficient and, outside of all but the default context, “interferes with the market for corporate control and impedes profit maximization,” resulting in wasteful legal transaction costs.²¹ They point to the preciseness afforded by allowing parties to create dickered terms, providing for reduction in uncertainty and increase in control during the creation of a business. At the same time, they argue that fiduciary duties lack such certainty and preciseness, calling them “a compilation of platitudes” that are difficult to determine or to predict.²² Contractarians believe, then, that while it may arguably be appropriate for courts to resort to fiduciary duties when examining cases involving business entities without a contract or with a contract silent on the

18. Miller, *supra* note 3, at 1618, quoting Robert Goddard, *Enforcing the Hypothetical Bargain: Sections 459-461 of the Companies Act 1985*, 20 COMPANY LAW. 66, 67-68 (1999).

19. See Hynes, *supra* note 13, at 443 (fiduciary duties should be viewed as “of a default nature only”).

20. Haynes, *supra* note 3; see also, Frank H. Easterbrook & David R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 429 (1993).

21. Miller, *supra* note 3, at 1618 (characterizing the perspective of scholars of the Chicago School of Economics. Miller notes that these scholars further opined that such inefficient misallocations of cost “will be passed on to consumers, resulting in an inefficient use of resources that will ultimately cause society to suffer.”); see also Claire Moore Dickerson, *Equilibrium Destabilized: Fiduciary Duties Under the Uniform Limited Liability Company Act*, 25 STETSON L. REV. 417, 453-55 (1995) (critiquing the cost-sensitive approach to fiduciary duties taken by contractarians).

22. Robert C. Art, *Shareholder Rights and Remedies in Close Corporations: Oppression, Fiduciary Duties, and Reasonable Expectations*, 28 J. CORP. L. 371, 386 (2003) (quoting Chiles v. Robertson, 767 P.2d 903, 911 (Or. Ct. App. 1989)).

contested issue, informed parties entering into a contract should be fully allowed to limit or wholly eliminate those duties. In other words, “because there are many situations in which it would be in the parties’ interest to waive default fiduciary duties, the ‘uncompromising rigidity’ of fiduciary duties imagined by Justice Cardozo is unworkable.”²³ Professor Ribstein, a chief advocate of the contractarian theory, characterizes the decision to accept fiduciary duties as the product of a cost-benefit analysis in which, during the initial stages of creating a business, participants weigh (i) the risks of losing opportunities for economic gain because of the burdens of fiduciary duty, against (ii) the risks inherent in waiving the benefits of security, loyalty, and disclosure that accompany the imposition of fiduciary duties.²⁴

The image of the fiduciary duty within the contractarian extreme assumes, of course, that all risks and decisions between joint-enterprisers are not only readily apparent, but personal to those involved in formulating the contract.²⁵ This first assumption characterizes all parties entering into a business form as savvy contractors. As such, “rational investors” must “understand ... the adaptive characteristics and opportunistic risks that normally attend corporate, partnership, and sole proprietorship form.”²⁶ The latter assumption reinforces the limited scope of the contractarian vision. Contractarians do not look beyond the relationship

23. Larry E. Ribstein, *Symposium on the Future of the Unincorporated Firm: Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH & LEE L. REV. 537, 546 (1997).

24. *Id.* at 543.

25. This contractarian idea is made explicit by Hynes, *supra* note 11, at 751, which calls the risk involved when entering into a partnership relationship “intensely personal, on both fiscal and reputational levels.” See also Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 253 (1977) (“Where a private transaction imposes no substantial cost on society or third parties, the parties to it should be allowed ... to ‘make their own deal’”).

26. Charles R. O’Kelley, Jr., *Filling Gaps in the Close Corporation Contract: A Transaction Cost Analysis*, 87 NW. U. L. REV. 216, 252 (1992).

created by the contract as it affects those parties privy to the contract, and they argue that “the relationship is [only] a business relationship, entered into for profit.”²⁷

B. The Social Responsibility Theory of the Business Entity

“Independence? That’s middle class blasphemy. We are all dependent on another, every soul of us on earth.”

- George Bernard Shaw²⁸

The followers of the social responsibility theory, as opposed to contractarians, believe that the influential relationships wrought in the creation and continuation of business entities extend far beyond those represented by mere market-based connections. Although the social responsibility theory recognizes that the primary impetus behind the formation of business entities is the pursuit of economic gain, its precepts instruct Courts to refuse to allow businesses to pursue wealth maximization at the expense of the greater society.²⁹ The social responsibility theory “begins with the assumption that people are all dependant on one another,” thus expanding into an omni-relational theory.³⁰ As described by one scholar:

The corporation’s basic structure consists of interactions with wide varieties of people ... For example, a small corporation may have employment contracts with its employees, supplier

27. See Hynes, *supra* note 13, at 751.

28. Grandfield, *supra* note 8, at 413 (citing GEORGE BERNARD SHAW, *PYGMALION: A ROMANCE IN FIVE ACTS THE FIFTH* act).

29. See, e.g., Vincent M. Di Lorenzo, *Equal Economic Opportunity: Corporate Social Responsibility in the New Millennium*, 71 U. COLO. L. REV. 51 (2000) (espousing a growing societal recognition of the possibility of fairly enforced social obligations on private enterprises); see also ROBERT B. DICKEY AND LEROY S. ROUNER, *CORPORATIONS AND THE COMMON GOOD* 47 (1986) (“Issues of institutional responsibility cannot be ignored or avoided in modern society. To do so is to condemn society to injuries that are publicly unacceptable, and in time, destructive”).

30. See Joseph W. Singer, *The Reliance Interest in Property*, 40 STAN. L. REV. 614, 656 (1988) (arguing for protections of the vulnerable parties based on the relationships between workers and corporations).

or service agreements with other companies, and a rental agreement for office space. Thus, a corporation fosters a system of connectedness among people. The idea that all people are interconnected is the embodiment of the theory.³¹

The social responsibility theory involves both an intra-organizational and an extra-organizational relationship aspect. Intra-organizational relationships – e.g. those between majority interests, directors, employees, shareholders and managers – are represented by the social relations aspect of the theory, which argues that, because of the interdependent relationships within a business entity, the business entity owes moral duties to all of its members and employees, while synchronously, all members and employees of the business entity owe moral duties to both each other and the entity itself.³² The extra-organizational aspect of the social responsibility theory argues that business entities also owe duties to the society in which they operate. This is founded upon the concept of “institutional responsibility,” which emphasizes the relational influences existing between business, government, and society at large, and examines how their relationships are further governed by societal norms and expectations in economics, politics and culture.³³ As one scholar notes, the recognition of the extent to which these entities affect each other is persuasive that “more than pure capitalism and the almighty dollar should rule.”³⁴

31. See Grandfield, *supra* note 8, at 403.

32. *Id.* at 397 (“Social responsibility, incorporated through social relations, means that social obligations exist due to relationships of mutual dependence in an enterprise and that people rely on the corporations as a result of these formed relationships.”).

33. See DICKEY & ROUNER, *supra* note 29, at 47 (“At a more intermediate level, business, government, and society are also interpenetrating systems, each independent, but also an influence on the others”).

34. Grandfield, *supra* note 8, at 405.

It may appear at first that the intra-organizational interests protected by social relations theory might conflict with the extra-organizational interests represented by society as a whole. For example, in the short term, the goal of protecting shareholders is unlikely to directly provide aid to impoverished members of society. A number of scholars postulate, however, that these interests become parallel in the long run:

It cannot be denied that social responsibility theory has been successful on one very important front: it has managed to persuade much of society ... that many conflicts between shareholders and non-shareholders arise only from a short-term perspective, and that their interests may merge in a long-term perspective because of the benefits of harmonious and productive relationships.³⁵

Social responsibility theorists argue that the Courts should play an active role in policing the morals of the marketplace. Advocates of the theory worry that the contractarians' virtual obsession with efficient cost-allocation "seems, at times, to elevate the achievement of economic efficiency above concepts of justice and equity."³⁶ As Allan W. Vestal perceives, "abandonment of fiduciary principles may be efficient for some participants, but it is not beneficial to society."³⁷

35. Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 454 (2006); see also ROBERT C. CLARK, CORPORATE LAW 390-92 (1986) and William T. Allen, *Our Schizophrenic Conception of the Corporation*, 14 CARDOZO L. REV. 261, 272-73 (1992).

36. Miller, *supra* note 3, at 1650.

37. Allan W. Vestal, *Fundamental Error in the Revised Uniform Partnership Act of 1992*, 73 B.U. L. REV. 523, 539.

Moreover, recent empirical evidence has allowed the social responsibility theorists to challenge the contractarians' claim that a regime of active judicial intervention is, in fact, less efficient.³⁸

Also, social responsibility theorists disagree with the contractarians' assumption that enterprisers are all necessarily savvy and informed contractors. They claim that the contractarian model "overlooks the vulnerability that has traditionally spurred the recognition of a fiduciary relationship."³⁹ As Professor Vestal notes, many parties that enter into business contractual arrangements are "unsophisticated participants, inadvertent partners ... and individuals with inadequate experience."⁴⁰ Also, contractarians' descriptions of actors in a contractual setting seem to greatly underestimate the complexity of many business relationships. For example, many members of business relationships might be wary of making demands that could be misinterpreted by the others as distrustful and harm the relationship, even though these demands might be necessary to protect them in case of unforeseen schisms in the future.⁴¹ Moreover, social responsibility scholars take issue with the contractarian presumption that all risks and results of contract terms are apparent to all enterprisers when entering into or amending a

38. This alludes to a Delaware study presented in Miller, *supra* note 3, at 1619-20 ("The assumption that fewer mandatory rules will result in decreased judicial intervention may not withstand the test of time...") Miller presents evidence that, although Delaware has an enabling statute which allows liberal limitation of fiduciary duties through contract for the LLC, it also had a substantially higher percentage of majority/minority disputes than California, New York, or Pennsylvania.

39. *Id.* at 1619; *see also* Grandfield, *supra* note 8, at 397 ("A high standard of business ethics results from the dependence and trust that people put on one another when they enter a business venture together and is a concept derived from fiduciary duty").

40. Vestal, *supra* note 37, at 541.

41. For examples and discussion about these psychological complexities of relationships, *see* Douglas K. Moll, *Minority Oppression & The Limited Liability Company: Learning (Or Not) From Close Corporation History*, 40 WAKE FOREST L. REV. 883, 954 (2005).

contract.⁴² The picture of the enterpriser that is painted by social relations and social responsibility scholars is, then, that of a person who is less than omniscient, and, as such, in danger of being manipulated or disadvantaged.

Unfortunately, the reality that many participants in any business entity are basically self-serving and do not naturally exhibit “the punctilio of an honor the most sensitive,” has frequently become patently evident by the fall of Enron and its accompanying accounting scandals. To combat the risks that any businessman faces at the hands of his self-interested fellow enterprisers, social responsibility theorists argue that “the law must have mechanisms and forms of analysis to encourage and enforce strong business ethics.”⁴³ One such mechanism is the powerful fiduciary duty tool, easily identified within the social responsibility theory because of its emphasis on elements of loyalty and trust inherent in relationships among enterprisers.

C. The Fiduciary Duty

“The greatest good for humans consists in relations of mutual good faith.”
- Decree of Delphi, 125 B.C.⁴⁴

Fiduciary duties of care and loyalty are a trait common to all varieties of business entities.⁴⁵ Fiduciary duties most basically represent the “duty to act with the highest degree of honesty and loyalty toward another person and in the best interests of the other person (such as

42. See Oliver E. Williamson, *The Modern Corporation: Origins, Evolution, Attributes*, 19 J. ECON. LIT. 1537, 1545 (1981); see also, Haynes, *supra* note 3, at 453-54 (“[P]arties may be unable to account for unforeseeable circumstances and need the benefit of applying the historical common-law fiduciary duties ... should such unforeseeable circumstances arise”).

43. Grandfield, *supra* note 8, at 381.

44. Scott FitzGibbon, *Fiduciary Relationships are not Contracts*, 82 MARQ. L. REV. 303 (quoting G. DAUX, DELPHES AU IIE AU IE SIECLE 369 (1936)).

45. See Miller, *supra* note 3, at 1622, n. 57.

the duty that one partner owes to another).⁴⁶ According to the fiduciary view, joint enterprisers should not be allowed to contract out of or compromise their duty of loyalty.⁴⁷ Fiduciarians see the duty of loyalty not as “the last refuge of failed planning,” but rather as an inherent and necessary component of the enterprising relationship, one that cannot be separated from the enterprise without destroying the nature of the enterprise itself.⁴⁸ So, where the contractarian will argue that the nature of all duties are rooted in and determined by the express or implied terms of the parties’ contract, the fiduciarian believes that “[r]egardless of the contractual structure to which ... partners [agree], the foundation of the relationship [is] a matter of status, not contract.”⁴⁹

For all the contractarians’ efforts to reduce the fiduciary duty to a contractual term, by their elevation of facilitation of transaction over regulation of conduct, they seem to miss the distinct moral and humanitarian disparities that become apparent when the fiduciary duty is

46. BLACK’S LAW DICTIONARY 523 (7th ed. 1999).

47. See, e.g., Haynes, *supra* note 3, at 452 (“According to the fiduciary view, loyalty is an inherent part of the relationship that should not be permissibly removed.”).

48. Franklin A. Gevurtz, *Squeeze-outs and Freeze-outs in Limited Liability Companies*, 73 WASH. U. L.Q. 497, 498; see also Vestal, *supra* note 37, at 537 (“By joining the partnership, each partner agrees to advance the collective interest and not the short term individual interest of the partner.”); and Claire M. Dickerson, *Is it Appropriate to Appropriate Corporate Concepts: Fiduciary Duties and the Revised Uniform Partnership Act*, 64 U. COLO. L. REV. 111, 118 (1993) (“Loyalty is owed precisely because of the relationship of fiduciary to beneficiary; the fiduciary must inevitably subordinate its own self-interest if it is to act loyally”).

49. Haynes, *supra* note 3, at 452 (quoting Vestal, *supra* note 37, at 535-36). For an explanation of the contractarian point of view, see J. William Callison, *Blind Men and Elephants: Fiduciary Duties Under the Revised Uniform Partnership Act, Uniform Limited Liability Company Act, and Beyond*, 1 J. SMALL & EMERGING BUS. L. 109, 117-18 (“In [the contractarian] view, the nature of the duties, fiduciary and otherwise, that exist in a partnership relationship depends on the relevant terms of the parties’ express or implied contract”).

examined as a tool to achieve the aims of the social responsibility theory.⁵⁰ As Professor FitzGibbon argues:

“Fiduciarist contractualism is the product of economic analysis of the law and thus suffers from the shallowness of ‘lawyer’s economics.’ Economic analysis in this area is a branch of welfare economics and suffers from the shallowness of ‘economists’ ethics.”⁵¹

To conflate these two legal ideologies, then, is to wantonly denigrate the fiduciary duty and to ignore the symbiosis of vital societal relationships and pressing moral responsibilities inherent in any business enterprise. This perfunctory conflation serves as the driving impetus behind the modern contractarian movement towards the limitation of fiduciary duties and restriction of judicial intervention in private business entities.

It has been stated that the “defining tension” within modern corporate governance is that between deference to business decisions and the scope of judicial review.⁵² Where the business judgment rule and the opt-out provision might be considered the contractarians’ greatest weapons with which to achieve freedom to pursue one’s self-interest, the fiduciary duty can be seen as the social responsibility theorists’ most powerful tool with which to infuse the business entity with morality and “institutional responsibility,” so elevating the interests of a common enterprise above the personal interests of its participants.⁵³ The contractarians’ ultimate goal of allowing

50. For an overview of how the history and foundations of fiduciary principles differ from that of contract law, see FitzGibbon, *supra* note 44, at 305 (“This Article explores the nature of fiduciary relationships, shows that they arise and function in ways alien to contractalist thought, and that ... they facilitate the doing of justice [and] promote virtue.”). For a description of the contractarian view, see Velasco, *supra* note 35, at 444 (“Rather than focusing on regulating the conduct of the various stakeholders, the goal of corporate law should be to facilitate transactions among them”).

51. Fitzgibbon, *supra* note 44, at 305.

52. E. Norman Veasey, *The Defining Tension in Corporate Governance in America*, 52 *BUS. LAW.* 393, 403 (1997).

53. Grandfield, *supra* note 8, at 393 (“[E]nforcing fiduciary duty principles uses the power of the law to inspire and enforce high standards of business ethics”); see also Lawrence E. Mitchell, *The Death of The Fiduciary Duty in Close Corporations*, 138 *U. PA. L. REV.* 1674 (1990) (arguing that enforcement of the old regime of strict fiduciary duties is the best way to combat minority oppression).

enterprisers to “opt-out” of fiduciary duties by contract would disarm courts of their most powerful weapon to combat minority oppression within the business enterprise. To protect minority interests from oppression within private business entities, courts must take an assertive step toward a resurgence of strict common-law fiduciary duties, remembering that “reverence for the written contract must be tempered with the recognition that judicial review is a good and essential thing ...”⁵⁴

Part 2: Minority Oppression within the Closed Corporation

A majority of jurisdictions have readily encouraged the use of special judicial interventions to protect the interests of shareholders within close corporations.⁵⁵ As a result, the oppression doctrine was born in the close corporate context, serving as a steadfast advocate against the abuse of minority interests and becoming an advance guard for the further development and extension of common law fiduciary duties. In this part I will argue that this development is rooted in the recognition of the significance of relationships among shareholders inherent in all facets of close corporations- from employment to management. As such, the oppression doctrine and fiduciary duties applied within close corporations can be readily attributed to the acknowledgment of the applicability of the social responsibility and social relations theories within this context.

A. Why Close Corporations are Susceptible to Minority Oppression

54. Miller, *supra* note 3, at 1654.

55. This movement was spearheaded by a small number of influential scholars writing in the 1940’s that special rules should be applied in the close corporate context because of its partnership-like attributes. For examples, *see, e.g.*, Carlos D. Israels, *The Close Corporation and the Law*, 33 CORNELL L.Q. 488 (1948); *see also* Norman Winer, *Proposing a New York “Close Corporation Law,”* 28 CORNELL L.Q. 313 (1943).

A close corporation is a business organization “typified by: (1) a small number of shareholders; (2) no ready market for the corporate stock; and (3) substantial majority shareholder participation in the management, direction and operations of the corporation.”⁵⁶ This category encompasses the majority of corporations.⁵⁷ While most shareholders in publicly held corporations participate merely as idle investors, most shareholders in close corporations expect to contribute labor and participate in managerial decisions.⁵⁸ They often seek employment within the corporation in order to better guide their investment; “Indeed, [they] may well invest in a closely held corporation for the purpose of providing themselves with jobs and salaries.”⁵⁹ Also, participants in a close corporation are often linked by family or personal relationships beyond those shared by usual investors.⁶⁰ As stated by one scholar, “[In a] closely held corporation ... everyone knows everyone.”⁶¹ Because of all of these factors, “a more intimate and intense relationship exists between capital and labor” within a close corporation.⁶²

56. Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 511 (Mass. 1975).

57. See Art, *supra* note 22, at 382-83.

58. See Robert A. Ragazzo, *Toward a Delaware Common Law of Closely Held Corporations*, 77 WASH. U. L.Q. 1099, 1102 (1999) (“The traditional model of the publicly held corporation treats shareholders as passive investors ... [while] shareholders in closely held corporations often expect to participate in the corporation’s management”).

59. *Id.* at 1103.

60. See Robert B. Thompson, *Corporate Dissolution and Shareholders’ Reasonable Expectations*, 66 WASH. U. L.Q. 193, 196 (1988) (describing the relationships between typical participants within close corporations). See also *Bostock v. High Tech Elevator Indus.*, 616 A.2d 1314, 1320-21 (N.J. Super. Ct. App. Div. 1992) (“Close Corporation[s] frequently originate in the context of personal relationships. Often such business entities are formed by family members or friends”).

61. Matheson & Maler, *supra* note 7, at 659-60.

62. Robert B. Thompson, *The Shareholder’s Cause of Action for Oppression*, 48 BUS. LAW. 699, 702 (1993).

The close corporation has been distinguished from the public corporation since as early as 1912, when a New York Court made a reference to “private enterprises [that] ... were little more ... than chartered partnerships.”⁶³ Because of the complex relationships involved in close corporations, their partnership-like qualities, and the lack of a ready market for their shares, many of the general principles of corporate law do not adequately protect the interests of shareholders within the close corporate context. For example, because “[t]raditional corporate law ... defaults to norms of majority rule and centralized control,” it leaves minority investors in close corporations ill equipped to counter majority decisions that adversely affect their financial and participatory interests.⁶⁴ This is because most corporate power is generally internalized by a board of directors, and -- unlike a publicly held corporation -- within a close corporation this board is frequently controlled by those holding majority shareholder interests (represented by either one party with a majority of shares or a majority of shareholders jointly acting as one party).⁶⁵ Such “[v]oting control gives the majority shareholder or shareholder group the keys to the corporate machinery.”⁶⁶ So, while holding the majority voting power, those with majority interests have the ability to pursue their own gain by taking advantage of and acting adversely to

63. Ripin v. Atlantic Mercantile Co., 98 N.E. 855, 856 (N.Y. 1912).

64. Moll, *supra* note 41, at 905. See also David C. Crago, *Fiduciary Duties and Reasonable Expectations: Cash-Out Mergers in Close Corporations*, 49 OKLA. L. REV. 1, 7 (“The vulnerability of the investment of minority shareholders to majority action caused courts to develop doctrines limiting the ability of the majority to act”).

65. See Moll, *supra* note 41, at 889.

66. Jeffrey M. Leavitt, *Burned Angels: The Coming Wave of Minority Shareholder Oppression Claims in Venture Capital Start-Up Companies*, 6 N.C. J. L. & TECH. 223, 231 (2005).

the minority shareholders.⁶⁷ The most ubiquitous methods by which they achieve this abuse are the freeze-out and the squeeze-out.

B. The Freeze-out in the Close Corporate Context

Professor F. Hodge O’Neal has described the “freeze-out” or “squeeze-out” as “the use by some of the owners or participants in a business enterprise of strategic position, inside information, or powers of control, or the utilization of some legal device or technique to eliminate from the enterprise one or more of its owners or participants.”⁶⁸ A freeze-out generally refers to an aggressive machination in which the majority interest-holders force a merger with a corporation which they also control under terms which force the minority to sell their shares for an unreasonably low value.⁶⁹ A squeeze-out is accomplished by using their voting power to force the minority to sell its shares to corporation for an unfair price.⁷⁰ This is usually done by a familiar sequence: (1) terminating the minority’s employment in the corporation, (2) voting the minority off of the corporation’s board, (3) using the board to declare little or no dividends, while continuing to pay the majority a salary, and, as the minority has now been effectively stripped of all possible return on their investment or opportunity to participate in management of the

67. See, e.g., *Estate of Schroer v. Stamco Supply, Inc.*, 482 N.E.2d 975, 979 (Ohio Ct. App. 1984) (“[majority interests have the ability to exercise] manipulative use of corporate control to eliminate minority shareholders, or to reduce their share of voting power or percentage of ownership of assets, or otherwise unfairly deprive them of advantages or opportunities to which they are entitled.”).

68. F. HODGE O’NEAL & ROBERT B. THOMPSON, O’NEAL’S OPPRESSION OF MINORITY SHAREHOLDERS §1.01 (2d e. 1985). See also James M. Van Vliet, Jr. and Mark D. Snider, *The Evolving Fiduciary Duty Solution for Shareholders Caught in a Closely Held Corporation Trap*, 18 N. ILL. U. L. REV. 239, 252-53 (1998) (defining a freeze out/squeeze out as “overbearing heavy handed conduct to literally force a particular shareholder out of the corporation, by coercing the shareholder to sell his or her shares ... or by barring the shareholder’s participation in the corporation without a sale of shares.”).

69. See Leavitt, *supra* note 66, at 232-33. For a real-life example of the use of a predatory freeze out merger, see *Gabhart v. Gabhart*, 370 N.E.2d 345 (Ind. 1977).

70. Leavitt, *supra* note 66, at 232.

corporation, (4) offering to purchase the minority's stock at an unreasonably low price.⁷¹ Each of these tactics involves both a participatory and a financial aspect.⁷² Through them, the majority can effectively terminate the minority's involvement in the corporation while synchronously acquiring their interest for an unfair compensation, consuming the minority's investment altogether.

Notably, the squeeze-out or freeze-out must be manipulated by a predatory majority with the motive of benefiting themselves and their personal interests in order to be afforded judicial review. If the majority can show a legitimate business purpose for their actions – by, for example, showing that the dismissed employee was demonstrably inadequate – Courts will not likely come to the minority's aid. Still, as portended by the rising popularity of the oppression doctrine in a majority of jurisdictions, Courts are beginning to become wary of applying the business judgment rule when they are presented with evidence that minority interests are being systematically undervalued and unfairly disadvantaged in order to benefit the majority interests.

C. Judicial Response: The Oppression Doctrine

Most jurisdictions have recognized that the unique characteristics of a close corporation evidence a special need for judicial intervention to prevent the abuse of minority shareholders.⁷³

71. For a classic real-life example of this sequence in action, *see Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1976). This is easily achievable because investors in close corporations generally opt to receive returns on their investment through a salary as opposed to dividends, *see, e.g.*, Daniel S. Kleinberger, *Why Not Good Faith? The Foibles of Fairness in the Law of Close Corporations*, 16 WM. MITCHELL L. REV. 1143, 1148 (1990) (“Payout is frequently in the form of salary rather than dividends”).

72. *See Ragazzo, supra* note 58, at 1119.

73. *See Matheson, supra* note 7, at 688 (“The prevailing view in most states is that oppression (or its statutory equivalent) can be established when the majority shareholder breaches her heightened fiduciary duties or violates the reasonable expectations of the minority shareholder.”).

What would become the oppression doctrine originated in the 1933 Illinois Model Business Corporation Act (“IMBCA”).⁷⁴ The IMBCA introduced the idea that oppression within a corporation could be a reason for a Court to demand liquidation.⁷⁵ The “oppression” language from the IMBCA was later imported into the remedies section of the Model Business Corporation Act (“MBCA”), which authorizes judicial dissolution if “the directors or those in control of a corporation” commit “fraudulent, oppressive, or illegal conduct.”⁷⁶ Interestingly, this sole mention of oppression in the concluding sections of the Act has become the “indistinct” statutory anchor for all later judicial action upon shareholder activities.⁷⁷ A majority of states now permit courts to employ appropriate equitable remedies, such as a court ordered buy-out, rather than the cumbersome dissolution option, making judicial relief for oppressed minority shareholders a much easier and more attractive task for courts.⁷⁸ Even in jurisdictions which are not equipped with an oppression-triggered dissolution statute, however, Courts have provided relief to injured minority shareholders by allowing a direct cause of action for breach of a fiduciary duty between shareholders.⁷⁹ Because of similarities between the statutory cause of action and the direct fiduciary duty, it has been suggested that these two judicial strategies are

74. 1933 Ill. Laws 308-87.

75. *Id.*, discussed in William R. Quinlan & John F. Kennedy, *The Rights and Remedies of Shareholders in Closely Held Corporations under Illinois Law*, 29 LOY. U. CHI. L. J. 585 (1998).

76. Model Bus. Corp. Act § 14.30(2) (2001).

77. Art, *supra* note 22, at 375.

78. *See, e.g.*, F. HODGE O’NEAL AND ROBERT B. THOMPSON, O’NEAL AND THOMPSON’S CLOSE CORPORATIONS AND LLC’S § 9:30 (2004) (“The most dramatic change in legislative and judicial thinking on solutions for close corporation problems is reflected in the increased popularity of a buyout as a remedy for deadlock or dissension. Legislative or judicial support for this remedy now exists in most states, although the criteria for its use are not uniform”).

79. *See* Thompson, *supra* note 62, at 739 (“It should not be surprising that the direct cause of action is developed particularly in states without an oppression statute and provides a vehicle for relief for minority shareholders in a close corporation where the statutory norms reflect no consideration for the special needs of such enterprises”).

best thought of as “two sides of the same coin – i.e., the shareholder’s cause of action for oppression.”⁸⁰ Courts have expanded upon this cause of action for oppression by developing two distinct judicial maneuvers by which they have protected minority shareholders from oppression within close corporations: (i) through applications of fiduciary duties between controlling and minority shareholders, and (ii) through barring oppression as a breach of the “reasonable expectations” of minority shareholders.

i. The Majority View: Fiduciary Duties and the Frustration of Reasonable Expectations Standard

In most jurisdictions, fiduciary duties resembling those between partners have been enthusiastically incorporated into the close-corporate context because of recognition of the parallels between the two business entities, including affirmation of the similarly strong relationships of trust and loyalty necessary for success and cohesion within both partnerships and close corporations. As evidence of this similarity, close corporations are often referred to as the “partnership clothed in corporate form” or “incorporated partnerships.”⁸¹

Fiduciary duties were first specifically applied to the shareholder relationship in the close corporate context by the Massachusetts Court in the seminal case of *Donahue v. Rodd Electrottype, Co.*⁸² In defining the fiduciary duty that majority shareholders owe minority shareholders, not only did the Court import Judge Cardozo’s verbatim description of the partnership fiduciary duties from *Meinhard*, but they supplemented the definition with rhetoric of

80. Moll, *supra* note 41, at 895.

81. Matheson & Maler, *supra* note 7, at 675 (“Courts [have] analogized that the closely held corporation is essentially a partnership clothed in corporate form and that shareholders owe a similar duty”). See also Van Vliet, Jr. & Snider, *supra* note 68, at 239 (“All shareholders, not just controlling shareholders, in ‘incorporated partnerships’ owe the heightened fiduciary duty of a partner”) (quoting Hagshenas v. Gaylord, 557 N.E.2d 316, 323 (Ill. App. Ct. 1990)).

82. 328 N.E.2d 505, 515 (Mass. 1975).

their own, declaring, “Just as in a partnership, the relationship among the shareholders must be one of trust, confidence and absolute loyalty if the enterprise is to succeed.”⁸³ They equated the duty owed between shareholders in close corporations to that owed between partners, arguing that as fiduciaries, when certain shareholders are positioned to gain advantage by their status as majority interest-holders, they “may not act out of avarice, expediency, or self-interest in derogation of their duty of loyalty to the other shareholders and to the corporation.”⁸⁴

Myriad jurisdictions outside of Massachusetts have followed the *Donahue* lead in declaring the existence of partnership-like fiduciary duties between shareholders within close corporations.⁸⁵ In fact, the idea that shareholders in close corporations owe fiduciary duties to one another similar to the duties owed between partners has become such a popular notion that scholars refer to it as “nearly universally accepted.”⁸⁶ As summed up by two scholars and practitioners, “the majority rule is now that closely held corporation shareholders owe fiduciary duties directly to one another, and that a breach of these duties results in actionable conduct, usually described as minority oppression.”⁸⁷

However, even Massachusetts – the progenitor of the imposing *Donahue* standard – later toned down its fiduciary description by admitting that strict adherence to the *Donahue* standard would “unduly hamper [the majority’s] effectiveness in managing the corporation in the best

83. *Id.* at 512.

84. *Id.* at 515 (close corporation shareholders “owe to one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another.”).

85. *See, e.g.*, *Guy v. Duff & Phelps, Inc.*, 672 F. Supp. 1086, 1090 (N.D. Ill. 1987); *Orchard v. Covelli*, 590 F. Supp. 1548, 1556-59 (W.D. Pa. 1984); *W & W Equip. Co. v. Mink*, 568 N.E.2d 564, 570-71 (Ind. Ct. App. 1991); *Evans v. Blesi*, 345 N.W.2d 775, 779 (Minn. Ct. App. 1984); *Fought v. Morris*, 543 So. 2d 167, 170-71 (Miss. 1989); *Crosby v. Beam*, 548 N.E.2d 217, 220-21 (Ohio 1989); *Estate of Schroer*, *supra* note 67, at 981.

86. *Crago*, *supra* note 64, at 1-2.

87. *Matheson & Maler*, *supra* note 7, at 663-64.

interests of all concerned.”⁸⁸ Massachusetts summarily refused, however, to renege on its application of fiduciary duties between shareholders in close corporations.⁸⁹ Rather, in later Massachusetts cases the Court argued that it was necessary for it to use judicial discretion to seek a proper balance between the majority’s right to “selfish ownership” of the corporation and their attendant fiduciary obligation to the minority.⁹⁰ Through this balancing test, the Court allows that a minority shareholder’s appeal to the fiduciary duty for relief can be defeated if the majority can show a legitimate business purpose for their actions, and the minority cannot show an alternate, less-oppressive option by which the majority might have achieved the same ends.⁹¹ Accordingly, “courts must weigh the legitimate business purpose, if any, against the practicability of a less harmful alternative.”⁹²

The strategy that Massachusetts has adopted by employing this balancing test reflects a widely recognized view of fiduciary duties as “exist[ing] in constant and unavoidable tension with the prerogative of the majority shareholders to determine corporate policy.”⁹³ The balancing test seems to provide a proper and rational compromise between the initiatives supporting business judgment and the Court’s interest in preventing oppressive conduct. The balancing test serves to remove a potentially oppressive situation from the uncompromising

88. *Wilkes*, 353 N.E.2d at 663.

89. *Id.*; see also Callison, *supra* note 48, at 148-52 (providing a chronologic discussion of the fiduciary duty as applied in Massachusetts after Donahue).

90. *Wilkes*, 353 N.E.2d at 663.

91. See Callison, *supra* note 48, at 150 (explaining the balancing test posited in *Wilkes*); see also *Wilkes*, 353 N.E.2d at 663 (for an example of when no valid business purpose could be shown, thereby allowing the imposition of fiduciary duties so that the minority could prevail on an oppression theory); *Smith v. Atlantic Properties, Inc.*, 422 N.E.2d 798 (Mass. 1981) (for a later example of Massachusetts applying a balancing test).

92. *Wilkes*, *supra* note 71, at 663.

93. Art, *supra* note 22, at 387.

shield of the business judgment rule, as it allows minority shareholders to defeat the business purpose defense by showing an alternate means through which the business might have achieved the same purpose without oppression. However, in allowing a corporation to present the business motives as mitigating excuses for potentially oppressive actions, the balancing test should also temper fear that applying the fiduciary duty in this context will become the catalyst for a judicial fiduciary frenzy.

Notably, the idea that controlling shareholders owe fiduciary duties to the minority has been extended into public corporations as well, and case law describing that duty harkens back nearly a century.⁹⁴ Still, Courts have not generally wielded the fiduciary duty with the same vigor in public corporations as in the close corporate context. This may be because there are simply fewer cases in which a single shareholder or group of shareholders is able to acquire control within a public corporation.⁹⁵ Professor F. Hodge O’Neal, however, has been quick to suggest that “there is a growing recognition that controlling shareholders [in all private business entities] stand in a fiduciary relationship to the corporation and to minority shareholders.”⁹⁶

Minority oppression through squeeze-outs or freeze-outs is easily confounded through implementation of the fiduciary duty.⁹⁷ As stated by one scholar, “[t]he typical freeze-out

94. See, e.g., *Ragazzo*, *supra* note 58, at 1135 (“Controlling shareholders ... have a fiduciary duty to the minority in all corporations, including publicly held corporations”); see also *Pepper v. Litton*, 308 U.S. 295, 306 (1939) (“a director is a fiduciary ... [and] [s]o is a dominant or controlling stockholder or group of stockholders”); *Southern Pacific Co. v. Bogert*, 250 U.S. 483, 487-88 (1919) (“the majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers and directors”).

95. See *Leavitt*, *supra* note 66, at 238 (“This kind of strong influence from a few shareholders is rare in public companies, but it is typical in close corporations and venture capital start-ups”).

96. O’Neal & Thompson, *supra* note 68, at §7:13.

97. See, e.g., *Orchard v. Corvelli*, 590 F.Supp. 1548, 1557 (W.D.Pa.1984), *aff’d*, 802 F.2d 448 (3rd Cir.1987) (“Any attempt to ‘squeeze out’ a minority shareholder must be viewed as a breach of this fiduciary duty.”).

scheme is illegal, whatever the standard of judicial review, in any jurisdiction that accepts the basic principle that the majority owes a fiduciary duty to the minority in a closely held corporation.”⁹⁸ Also, the implementation of fiduciary duties in this context infuses the shareholder relationship with a moral component, thereby encouraging just and fair relationships. In these dual roles, the true value of strong fiduciary duties emerges: not only as an easily applicable obstruction to oppression, but also as a champion for the promotion of the kinds of equitable relationships espoused by the social responsibility theory of corporate law.

ii. Frustration of Reasonable Expectations Standard

*“[P]eople may enter closely-held businesses in the same manner as they enter marriage: optimistically and ill-prepared.”*⁹⁹

An increasing number of states have adopted the “reasonable expectations standard” by which to determine whether oppression has occurred in a given case. This standard differs from the application of fiduciary duties in that it “focus[es] not on the actions of the majority shareholder but on the expectations held by the minority shareholder.”¹⁰⁰

The reasonable expectations standard was foreshadowed in cases in a number of jurisdictions before it was made explicit.¹⁰¹ The standard was first applied and developed in New

98. Ragazzo, *supra* note 58, at 1106-07.

99. Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and its Impact Upon Valuation of Minority Shares*, 65 NOTRE DAME L.REV. 425, 426 (1990).

100. Matheson and Maler, *supra* note 7, at 664.

101. *See Wilkes*, 353 N.E.2d at 662-63 (“In sum, by terminating a minority stockholder’s employment or by severing him from a position as an officer or director, the majority effectively frustrate[d] the minority stockholder’s purposes in entering on the corporate venture...”); *see also* *Exadaktilos v. Cinnaminson Realty Co.*, 400 A.2d 554, 561 (N.J. Super. Ct. Law. Div. 1979) (“[T]he special circumstances, arrangements and personal relationships that frequently underlie the formation of close corporations generate certain expectations among the shareholders concerning their respective roles in corporate affairs, including management and earnings.”).

York's *In re Topper*.¹⁰² In that case, two shareholders banded together to oust a third after he had terminated his job of twenty-five years in the pharmaceutical business, moved from Florida to New York to join the other shareholders, and invested his life savings in the venture.¹⁰³ Although Topper's one-third interest in the venture remained intact, the court held that oppression had occurred because the other shareholders, by firing him, had violated his reasonable expectations to have an active role in the labor and management of the corporation.¹⁰⁴ In explaining their reasoning, the Court quoted Professor F. Hodge O'Neal:

Many participants in closely held corporations are 'little people,' unsophisticated in business and financial matters. Not uncommonly a participant in a closely held enterprise invests all his assets in the business with an expectation, often reasonable under the circumstances even in the absence of an express contract, that he will be a key employee in the company and will have a voice in business decisions.¹⁰⁵

Four years later, the New York Court of Appeals applied the "reasonable expectations" standard in *In re Kemp & Beatley, Inc.*, providing that a shareholder who "reasonably expected that ownership in the corporation would entitle him or her to a job, a share of corporate earnings, [or] a place in corporate management ... [is oppressed when] others in the corporation seek to defeat those expectations."¹⁰⁶ The *Kemp* case established itself as "particularly influential" in other jurisdictions, confirming New York as the forerunner among a

102. *In re Topper v. Park Sheraton Pharmacy, Inc.*, 433 N.Y.S.2d 359 (N.Y. 1980); *see also* Grandfield, *supra* note 8, at 385-86 (in-depth discussion of *In re Topper*).

103. *In re Topper v. Park Sheraton Pharmacy, Inc.*, 433 N.Y.S.2d 359, 362 (N.Y. 1980)

104. *Id.*

105. *Id.* at 365 (quoting F. Hodge O'Neal, *Close Corporations: Existing Legislation and Recommended Reform*, 33 BUS. LAW. 873, 884 (1978)).

106. *Matter of Kemp & Beatley, Inc.*, 484 N.Y.S.2d 799, 805 (1984).

large group of jurisdictions that became advocates of the reasonable expectations standard.¹⁰⁷ A number of state corporate statutes have since specifically provided that the reasonable expectation of a shareholder can be a consideration in a court's determination of an appropriate judicial remedy.¹⁰⁸ The reasonable expectations standard has also garnered a healthy amount of support among academics, being called "the most reliable guide to a just solution of a dispute among shareholders ... in the typical close corporation."¹⁰⁹

iii. The Minority View: No Fiduciary Duty Between Shareholders

The fiduciary aspect of the oppression doctrine is not without its adversaries. Cynics have animadverted upon the *Donahue* application of partnership fiduciary duties in the close corporate context, referring to this extension of fiduciary duties as "galloping Meinhardism."¹¹⁰ Chief among these are the contractarians, championed by the State of Delaware. Delaware was called upon to address the fiduciary status between shareholders in close corporations after the wave of the oppression doctrine had managed to find support in a majority of other states. Fiduciarians across the country held their breath, hoping that Delaware – arguably the most powerful influence in corporate law – would join their cause. Pledging avid allegiance to its well-known contractarian inclinations, however, Delaware chose to swim against

107. Douglas K. Moll, *Shareholder Oppression & Reasonable Expectations: Of Change, Gifts, and Inheritances in Close Corporation Disputes*, 86 MINN. L. REV. 717 (2002). Examples of other jurisdictions adopting the standard include: Montana (*Fox v. 7L Bar Ranch Co.*, 645 P.2d 929, 933 (Mont. 1982)); North Carolina (*Meiselman v. Meiselman*, 307 S.E.2d 551, 561-63 (N.C. 1983)); North Dakota (*Balvik v. Sylvester*, 411 N.W.2d 383, 387 (N.D. 1987)); and Texas (754 S.W.2d 375, 381 (Tex. App. 1988)).

108. See generally Minn. Stat. § 302A.751 (2000); N.D. Cent. Code § 10-19.1-115 (2000); 805 Ill. Comp. Stat. 5/12.56 (2000).

109. Crago, *supra* note 64, at 12 (quoting O'Neal, *supra* note 105, at 886).

110. See Barbara Ann Banoff, *Company Governance Under Florida's Limited Liability Company Act*, 30 FLA. ST. U. L. REV. 53, 59 (2002).

the tide, declining to recognize that fiduciary duties exist between majority and minority shareholders within close corporations.

The Delaware Court was first given the opportunity to apply fiduciary duties between shareholders in *Nixon v. Blackwell*.¹¹¹ The case involved a corporate practice of buying life insurance for its executive employees and then using the money it collected upon those employees' deaths to buy back their shares from their estate. The non-employee shareholders questioned this practice, complaining that, as they were not afforded the chance to sell their stock through this practice, some shareholders were being unfairly afforded a means of liquidation not available to all of the others.¹¹² The Delaware Chancery Court had applied the *Donahue* standard in embracing the fiduciary aspect of the oppression doctrine within close corporations and finding this practice oppressive. The Delaware Supreme Court pertinaciously overturned this ruling, summarily refusing to recognize "any special, judicially-created rules to 'protect' minority stockholders of closely held Delaware Corporations."¹¹³ The Delaware Supreme Court explained its reasoning by asserting that their legislation enabled shareholders in closely held corporations to regulate their relationship by contract. Because, then, it is possible for minority shareholders to protect themselves through contractual means, Delaware declared that its courts would not offer judicial relief to those who fail to successfully protect themselves through contract.¹¹⁴

111. 626 A.2d 1366 (Del. 1993).

112. *Id.* at 1376-77.

113. *Id.* at 1379.

114. *Id.* at 1360; *See also* Del. Code Ann. Tit. 8, §§341-356 (1998).

In so holding, Delaware adopted a stance of rigid contractarianism, failing to recognize the “significant limitations on the minority’s ability to protect itself by contract” within the close corporate context.¹¹⁵ Professor Robert Ragazzo presents a compelling compilation of such limitations:

“[T]o the extent such [potential future oppression] can be foreseen, it may be impossible to formulate contractual standards that are sufficiently certain and definite for a court to enforce. More importantly, closely held corporations are the corporations least likely to involve lawyers making extensive efforts to assure that the corporation is formed in accordance with the wishes of the enterprise. The smaller the enterprise, the larger the relative transaction costs of contracting for special relationships between shareholders.”¹¹⁶

Even for those enterprisers who have the means and capability to plan for their protection in case of dissension, impediments barring effective contracting remain, particularly because of the relationships of trust and loyalty that are necessary for businessmen to willingly embark on an enterprise together. Professor Douglas Moll suggests:

“[A] minority shareholder may be hesitant to even raise the topic of dissension because of a fear that it will damage the trust between the shareholders – trust that is critical to the operation of any small business. This hesitation may result in no planning for dissension at all.”¹¹⁷

Therefore, while the ability to effectively contract may be complicated by the “trust between the shareholders,” the fiduciary duty is born of that trust and so is better able to embrace and protect business entities like close corporations which necessarily involve the

115. Ragazzo, *supra* note 57, at 1129.

116. *Id.* at 1129-30; *cf. Freezing out Minority Shareholders*, 74 HARV. L. REV. 1630, 1642 (1961) (“Even where the minority shareholders lack sufficient bargaining power to obtain [a protective contract] agreement, they at least are likely to be made aware in the process of organizing the corporation of the majority’s power to alter their rights”).

117. Moll, *supra* note 41, at 913-15; *cf. Freezing out Minority Shareholders*, *supra* note 116, at 1642 (“Since in most cases the shareholders of a close corporation participate in its organization, they may have an opportunity by proper foresight in negotiating and drafting the charter to give themselves a veto power over fundamental structural change or other majority action affecting their rights”).

morally-charged relationships of trust and loyalty. In this light, it is easy to understand why the majority of states' courts have afforded themselves the utility of the fiduciary duty so that they can better combat and deter oppression between shareholders in the close corporate context.¹¹⁸ This has prompted many advocates of the fiduciary duty to question why the Supreme Court of Delaware chose not to equip itself comparably.¹¹⁹ Supporters of the fiduciary standard have attempted to provide an answer by pointing out that, as it did not involve a traditional freeze-out, *Nixon* did not present the most compelling case for the application of fiduciary duties between shareholders.¹²⁰ The Fifth Circuit, in *Hollis v. Hill*,¹²¹ also expressed doubt over Delaware's certainty in its resolution if confronted with a traditional freeze-out, pointing out that, "the Delaware Supreme Court has yet to consider ... whether a controlling shareholder is liable for actions taken with the purpose and effect of freezing out another shareholder."¹²¹ Therefore, advocates of the use of additional judicial protections through the importation of fiduciary duties

118. See Moll, *supra* note 41, at 960-61 ("Despite this broad ability to contract in the close corporation, most jurisdictions have concluded that a need still exists for a judicial 'backstop' – i.e., a need exists for a special shareholder oppression doctrine. This conclusion is presumably driven by the recognition that an ability to contract does not necessarily translate into the actual occurrence of effective contracting, even where such contracting is needed").

119. It should be noted here that Delaware does use an "entire fairness test" and the contractually determined good faith rule that it can implement in lieu of determining a fiduciary duty between shareholders. However, scholars suggest that these tests are more narrow than the fiduciary duty and will not provide adequate protection to minority interests, see Miller, *supra* note 3, at 1609 ("[A] broad and traditional approach to fiduciary duties is preferable to a narrower analysis of entire fairness or contractually oriented good faith because a broader formulation better reflects society's norms of ethical conduct, more adequately serves all sectors of the private business community, may be more effective in combating subtle freeze-out schemes, and does not presume that the parties' relationship is governed by a highly negotiated contract").

120. See Ragazzo, *supra* note 58, at 1134 ("[this] case did not involve a classic freezeout. There is, therefore, some hope that, when confronted with real evidence of a freezeout, the Delaware Supreme Court may reconsider its views in *Nixon* and hold, as the Chancery Court held in *Little v. Waters*, that the majority owes a fiduciary duty of fairness to the minority in the close corporation context."); see also Leavitt, *supra* note 65, at 251 ("In short, the *Nixon* court's assertion that contract terms should be the only means of minority shareholder protection in close corporations has not been formally resolved, and remains subject to serious debate").

121. 232 F.3d 460, 469 n.28 (5th Cir. 2000).

between shareholders in close corporations continue to hope that Delaware will, when faced with a real freeze-out, afford their oppressed minority shareholders some relief through the fiduciary duty. After all, in Emerson's weighty words, "a foolish consistency is the hobgoblin of little minds."¹²²

D. Contracting Out of Fiduciary Duties: The Exception to Oppression

Even in states that readily embrace and apply the fiduciary duty to prevent freeze-outs in the close corporate context, the fiduciary duty remains jeopardized by potential contractual encroachment. This problem originates, predictably, in the conflicting meanings ascribed to the fiduciary duty by scholars in the competing schools of contractarian and social responsibility theory. Social responsibility theorists focus on the relationships within and without business entities. They describe fiduciary duties as connate and immutable fixtures that naturally accompany the kinds of relationships of control and power inherent in close corporations.¹²³ Contractarians, on the other hand, claim that "[f]iduciary duties are standard form terms that are not appropriate for many firms" and that "the parties might reasonably decide that standard form duties are prohibitively costly."¹²⁴ Thus, as one scholar notes, "while traditionalists largely view fiduciary duties as moral mandates, contractarians perceive them as economic choices."¹²⁵

Although courts and scholars alike approach with hesitancy the prospect of circumventing the oppression doctrine by contracting out of fiduciary duties, the contractarians

122. See Ragazzo, *supra* note 58, at 1135 (quoting Ralph W. Emerson, Self Reliance and Other Essays 24 (Dover Thrift 1993)).

123. See *infra*, "Part Two".

124. LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES, § 9.04, 12 (2002).

125. Miller, *supra* note 3, at 1627.

have had a number of victories on this front. Even in Massachusetts, the State that first sang praises of shareholder fiduciary duties, some degradation of those duties has been tolerated. For example, in the 1989 case of *Evangelista v. Holland*, the shareholders had included a term in their preliminary contract that allowed for stock to be bought back from any shareholders at any time for a price below the market value.¹²⁶ This situation is usually symptomatic of a freeze-out scenario, but the Massachusetts Appeals Court refused to use strict fiduciary duties to bar the action. Instead, they provided that where all of the shareholders consented to terms in a contract before beginning their endeavor, their actions involved a “mutuality of risk” that gives the contract an “inherent fairness.”¹²⁷ Having so labeled the contract as substantively fair, the Court determined that fiduciary duties could not be used to prevent enforcement of the contract, even if the clause later appeared unfair in practice.¹²⁸

Massachusetts further allowed the contractarians to prevail against the fiduciary duty in *Blank v. Chelmsford Ob/Gyn, P.C.*¹²⁹ In that case, the three shareholder/employees of a close corporation had provided in a preliminary contract that they were all to be employees at will, terminable at any time for any reason by a majority vote of the board of directors. They stipulated that upon termination, the terminated shareholder/employee would have to relinquish all of his existing stock in the corporation, and the corporation would be obligated to buy it back. When, several years after forming the corporation, the board of directors decided to terminate one of the three original shareholders from his employment position, he responded by asserting

126. 27 Mass. App. Ct. 244 (Mass. App. Ct. 1989).

127. *Id.* at 249.

128. *Id.* (“Specific performance will not be refused just because the price now seems inadequate”).

129. 420 Mass. 404 (Mass. 1995).

that the strict fiduciary duties between shareholders in a close corporation prevented the corporation from firing any shareholders for any reason other than a legitimate business purpose.¹³⁰ In *Blank*, the terminated employee was not completely frozen out, as he was adequately compensated for his shares via the stock-purchase agreement. However, when *Blank* is juxtaposed with *Evangelista*, it is easy to see how a naive party to a contract might provide their more savvy counterparts with all of the tools necessary to carry out a true freeze-out by combining the diminution of employment rights with a clause that obligates the terminated employee to sell back their stock for a price below market. The Massachusetts Court did not seem to recognize this possibility, declaring that “there was no reason why an appeal to general fiduciary law should be used as a pretext for evading contractual obligations.”¹³¹ Still, it is uncertain what Massachusetts Courts would do if confronted with a fully contracted-for freeze-out. Advocates of the fiduciary duty have not given up hope. As suggested by two Massachusetts practitioners, “Because the [*Blank*] decision is so lacking in explicit reasoning, it is unclear just how wide-ranging its repercussions will be.”¹³²

There is hope that courts will refuse to allow contract to prevail over the fiduciary duty when faced with a compelling case of oppression. Even Delaware has put a limit on the scope of tolerable contractual waivers of the fiduciary duty (where it recognizes that a fiduciary relationship exists). For example, in *Omnicare, Inc. v. NCS Healthcare, Inc.*, a case involving a

130. There was no question that such a legitimate purpose was lacking in the case. At oral argument on the defendants’ motion to dismiss, the defense provided that they had terminated Blank’s employment because he was not getting along with the other shareholders. *Blank v. Chelmsford Ob/Gyn, P.C.*, Middlesex Superior Court, Civil Action No. 94-1485-B (April 28, 1994).

131. *Id.*

132. Henry A. Sullivan & James J. Rooney, *Blank v. Chelmsford Ob/Gyn, P.C.: Further Developments in the Rights of Employee/Shareholders of Close Corporations*, BOSTON BAR JOURNAL, 16, 17 (1996).

combination of merger and voting agreements that concertedly resulted in a corporate lock-up, the Delaware Supreme Court held that the contract was unenforceable, declaring that “the protection of ... contractual expectations must yield to the supervening responsibility of the directors to discharge their fiduciary duties on a continuing basis.”¹³³ Although the *Omnicare* holding is arguably limited to its facts, it also may have significance to other business types insofar as it suggests the existence of a solid core of fiduciary duties that cannot be impinged upon by contract.¹³⁴

Courts should consider the two-part formula of the oppression doctrine before considering whether to enforce contractual terms that seek to contract out of judicial scrutiny in light of the oppression doctrine. As discussed above, oppression protections normally allotted to minority shareholders include both appeals to the fiduciary duty and appeals to the reasonable expectations of the minority shareholders. The reasonable expectations approach is essentially an appeal to an implied contract. These expectations become important in the absence of a contract and seek to determine what terms the shareholders would have agreed upon had they reduced their expectations to a formal agreement.¹³⁵ Given these roots of the reasonable expectations doctrine, it intuitively follows that when a contract exists in which the parties listed their expectations, aggrieved parties should not be allowed to later sue and claim that their

133. 818 A.2d 914, 936, 939 (Del. 2003).

134. See Miller, *supra* note 3, at 1640 (“Although the *Omnicare* holding is limited to the context of coercive measures in connection with the merger of a public company, it has significance to all business entities insofar as it reveals the Delaware Supreme Court’s willingness to place limitations on the extent to which directors may contract away their fiduciary duties in private agreements”).

135. See Van Vliet & Snider, *supra* note 68, at 255 (“If the shareholders of a closely held corporation had reduced to a formal agreement their expectations with respect to participating in the corporation, the frustration of those expectations by deliberate action of another shareholder would provide grounds for relief... The courts, in the absence of a formal contract, in effect have sought to determine from the circumstances the reasonable expectations of shareholders ... and have held that the frustration of those expectations, without a valid business justification, is a breach of the fiduciary duty owed by shareholders to each other”).

expectations were different than those enumerated. Therefore, parties who have undertaken the expense and effort to enumerate their expectations in joining a venture should be barred from bringing a “reasonable expectations” claim when they later “get what they bargained for.”

Conversely, the fiduciary aspect of the oppression doctrine, however, should not be so easily thwarted by contract. The fiduciary approach differs from the reasonable expectations approach insofar as it contains a moral mandate: Cardozo’s “honor most sensitive.”¹³⁶ While the reasonable expectations approach “allows for a finding of oppression whether or not the majority acted wrongly,” the fiduciary approach allows Courts to step in and provide equitable relief to an oppressed party when another one of the parties has done something unfair or unethical without any legitimating business purpose.¹³⁷ Courts should not allow parties to contract out of the fiduciary duty, as contracts should not be used as a means by which parties may oppress their partners, co-workers, and joint enterprisers with impunity. Therefore, although the tools afforded the Court by the oppression doctrine may be limited by a contract, the Court should not be incapacitated by the mere presence of a contract. Rather, the court should still be free to apply judicial scrutiny to examine whether parties are using contract terms to unduly oppress their peers in violation of their fiduciary duties.

Interestingly, many examples of oppression under the reasonable expectations method are also violations under the fiduciary method. Consequently, oppressed holders of minority interests ought to be able to obtain relief even if subject to a contract that bars the

136. See, e.g., Art, *supra* note 23, at 395 (discussing the similarities and differences between the reasonable expectations and the fiduciary approaches to analyzing oppression).

137. *Id.* at 373.

application of the reasonable expectations standard.¹³⁸ Many cases use the reasonable and fiduciary approaches interchangeably, leading commentators to describe them as “not contradictory, as conduct that violates one may well also violate the other.”¹³⁹ In fact, one scholar suggests that the fiduciary duty and reasonable expectations approaches are most likely to lead to the same result in cases involving freeze-outs.¹⁴⁰ The Minnesota case *Pedro v. Pedro* offers one example.¹⁴¹ In that case, three brothers were each one-third interest-holders in a close corporation which manufactured luggage and leather products.¹⁴² One of the brothers, Alfred, discovered an accounting inconsistency of almost \$330,000, and when he confronted his brothers to demand an independent accountant be hired to investigate, his brothers threatened to fire him unless he ignored the discrepancy.¹⁴³ Nonetheless, Alfred hired an independent accountant. As a result, his brothers reacted by notifying him in writing that his status as an employee had been terminated, his salary and benefits were discontinued, and employees of the corporation were told that he had suffered a nervous breakdown.¹⁴⁴ In providing relief to Alfred, the Court used the reasonable expectations standard, awarding him damages because “in a closely held

138. *See id.* at 395 (“In many fact situations the [reasonable expectations and fiduciary] approaches could well lead to the same results, merely explained with differing terminology”)

139. F. HODGE O’NEAL & ROBERT B. THOMPSON, O’NEAL’S CLOSE CORPORATIONS, § 9.29 (3d ed. 1994); *see also* *Gimpel v. Bolstin*, 477 N.Y.S.2d 1014, 1019 (N.Y. 1984) (suggesting that both standards “will frequently be found to be equivalent”).

140. Douglas Moll, *Shareholder Oppression and Reasonable Expectations: Of Change, Gifts, Inheritances in Close Corporation Disputes*, 86 MINN. L. REV. 717, 753 at n.15, (April 2002).

141. 489 N.W.2d 798 (Minn. App. 1992), discussed in Grandfield, *supra* note 8, at 388-89 (described as “the most significant case to apply the reasonable expectations test as specifically set forth in a state corporate law statute”).

142. *Id.* at 799.

143. *Id.* at 799-800.

144. *Id.* at 800.

corporation, the nature of the employment of a shareholder may create a reasonable expectation by the employee-owner that his employment is not terminable at will.”¹⁴⁵

Even if the Pedro brothers had provided in a contract that they were all employees-at-will (making the reasonable expectation of employment argument unavailable to Alfred), it is likely that the Court would have employed the fiduciary duty to award Alfred damages under the oppression doctrine. Thus, even without appealing to Alfred’s reasonable expectations, then, the Court could have decided that the brothers’ actions in firing a shareholder/employee, especially in light of Alfred’s allegations of fraud, would be against the best interests of the corporations and a breach of their shareholder fiduciary duties to one another.¹⁴⁶

The social responsibility theory’s perspective provides an even more compelling reason to allow fiduciary duties to supersede contractual agreements. This theory suggests that the relationships among business enterprisers-- especially those involving shareholder/employees-- would be better served if courts refused to allow members to totally contract out of their fiduciary duties to one another. This would protect the interests of enterprisers who are poorly skilled in contracting. It would also protect those who are overly optimistic about the unlikelihood of future dissention and so conclude that demands for protective contract terms would be unnecessary and, indeed, might likely damage their relationship with their fellow enterprisers. Moreover, a number of scholars suggest that demanding strict fiduciary duties from all participants within a company will result in healthier and more productive companies. As noted by one scholar: “Business experts have ... recognized that the needs of workers must be

145. Pedro v. Pedro, 463 N.W.2d 285, 289 (Minn. App. 1990).

146. Discussed in Art, *supra* note 23, at 396.

taken into account in order to ensure a successful corporation. Management is rediscovering the value of loyalty.”¹⁴⁷

Because of the especially strong relationships necessitated by the nature of close corporations, Courts should look to the theory of the corporation which most prioritizes relational aspects – the social responsibility theory – in order to seek guidance on how to respond to the problem of dissention and oppression within the close corporate context.¹⁴⁸ This argument is especially strong in light of the employment interests usually manipulated through squeeze-outs and freeze-outs.¹⁴⁹ Much of a man’s identity is tied up in his occupation, exemplified by the adage: “By the work one knows the workman.”¹⁵⁰ This explains the profound sense of loyalty owed and expectation of trust deserved by joint enterprisers: they embark together on something that will, in the end, define them individually. Because the relationships developed between joint enterprisers as employees within close corporations are so compelling, the social responsibility theory advocates that it is a Court’s duty to provide a high level of judicial discretion to protect those employed in such relationships. By imposing high standards of fiduciary duties in such cases, Courts will be doing more than punishing an economic misallocation within a single corporation. They will be demanding that all enterprisers respect each other in the relationships that they create with one another – proclaiming that there are

147. Grandfield, *supra* note 8, at 400-401; *see also Two Cheers for Loyalty*, THE ECONOMIST, Jan. 6, 1996, at 49 (suggesting that many American companies, including Chick-Fil-A, L.L. Bean, Land’s End, Nike, and Intuit, have made a new commitment to encourage employee loyalty, recognizing it as “an essential ingredient to a successful business”).

148. *See, e.g.*, Grandfield, *supra* note 8, at 383 (“Within a corporation, a more intimate and intense relationship exists between capital and labor because the people involved often serve a triple role as shareholder, employee, and officer of the corporation”).

149. For a general overview of how employment is usually affected by freeze outs, *see Art, supra* note 23, at 384.

150. Jean de la Fontaine (1621-1695).

morals higher than those determined by the market. The development and enthusiastic acceptance of the oppression doctrine in a majority of jurisdictions is evidence that courts are beginning to recognize their duty to impose the fiduciary duty. Courts must not rely on contract terms alone, but be certain that oppression is not being abetted by exploitation of those contract terms by majority parties acting in violation of their shareholder fiduciary duties.

Part 3: Oppression within Partnerships

Partnerships arguably present the most compelling area for the enforcement of strict fiduciary duties.¹⁵¹ Indeed, as scholars have noted, “if it were not for the protection of fiduciary duties, partners would be at each others mercy.”¹⁵² Unlike alternative statutory business entities, partnership law was born of the same common law which fathered the fiduciary duty.¹⁵³ Partnership relationships were first described as fiduciary because every partner acting individually “has the agency power to commit partnership assets and to create partnership and individual liabilities ... [making it] necessary to provide rules that circumscribe the exercise of the partner’s managerial discretion.”¹⁵⁴ It was this fiduciarian aspect of partnerships which inspired Judge Cardozo to “[liken] a fiduciary to a trustee, and [impose] a duty that required

151. See generally Haynes, *supra* note 3, at 436 (“Fiduciary duties are among the most important aspects of partnership”). It is also important to note here that the arguments involving the fiduciary duty of partnerships in this section are equally applicable to the limited liability partnership (LLP). See Callison, *supra* note 49, at 160 (“Partnership fiduciary duties in LLPs are identical to those of ‘vanilla’ general partnerships because LLPs are general partnerships for all purposes, except that they are afforded statutory limited liability protection. This is, and should be, the case irrespective of the liability protection afforded the general partners because they remain in their capacities as agents for the partnership”).

152. JUDSON A. CRANE & ALAN R. BROMBERG, LAW OF PARTNERSHIP 389 (1968).

153. Talley, *supra* note 2, at 1005.

154. ALAN R. BROMBERG & LARRY E. RIBSTEIN, 2 BROMBERG AND RIBSTEIN ON PARTNERSHIP, §6.07 (a)(1) (2004).

‘uncompromising rigidity’ and the[aforementioned] ‘punctilio of an honor the most sensitive’ as the standard for fiduciary compoment.”¹⁵⁵

It was because of the close corporation’s resemblance to a partnership that courts decided to enforce partnership-like fiduciary duties between shareholders.¹⁵⁶ So, as fiduciary duties within the partnership context arguably grandfathered the oppression doctrine, it is odd that the latest trend within partnership law has been toward gradual erosion of the scope of the fiduciary duty, even when faced with evidence of oppression within partnerships.

Scholars and courts continually cede that partners are not allowed to directly contract out of the fiduciary duty.¹⁵⁷ However, savvy contractors have proven successful in myriad courtroom battles pitting contract against fiduciary duties, affecting a gradual undermining of the scope of fiduciary duties within partnership common law. When faced with the contract as an adversary, even Cardozo’s “finest loyalty” seems impotent.

This section will explore oppression within partnerships: partnership freeze-out, judicial response to oppression, and the conflict of fiduciary duties and contract within the partnership context. This section will then discuss the changes in fiduciary duties proposed in the Revised Uniform Partnership Act (RUPA) and the implications that adoption of the RUPA will have on the fiduciary duty within partnerships. Using evidence of the contractarians success in prevailing over the fiduciary duty, this part will again urge that the appeal to strengthened fiduciary duties

155. *Id.* at 1005-06.

156. Thomas Lee Hazen, *The Corporate Persona, Contract (and Market) Failure, and Moral Values*, 69 N.C. L. REV. 273, 294-95 (January 1991) (describing how duties in the corporate context – both public and close – were derived from the duties owed in a partnership).

157. *See, e.g.*, Jeff Schwartz, *Good Faith In Partner Expulsions: Application of a Contract Law Paradigm*, 9 CHAP. L. REV. 1, 6 (2005) (“There are ... some rules that cannot be contracted out of (e.g., partners can not agree to completely eliminate fiduciary duties)”); *see also* Van Vliet and Snider, *supra* note 68, at 265 (“Under partnership law, the fiduciary duty owed by partners cannot be destroyed by contract”); Revised Unif. P’ship Act § 103 (b)(3).

made in the close corporate context is just as applicable and equally necessary within the partnership context.

A. The Partnership Freeze-Out

Dissention happens. In fact, disagreements between partners are arguably as much of an inherent aspect of the partnership as the fiduciary relationship. Enterprisers joining together to create a partnership may have the best of intentions, but the combination of changes wrought with the passage of time, economic difficulties, and pressures arising whenever humans must work together on any common enterprise will inevitably lead to contention. Sometimes, disagreements will prove impossible to overcome, and partners will have to separate. Usually such separations are necessary and equitable final chapters of the partnership story. Oppressive freeze-outs in the partnership context occur, however, whenever less powerful (“minority”) partners are expelled by their more powerful (“majority”) co-partners for unjust reasons, by unfair means, or when resulting in an inequitable compensation to the minority for their interest.

Cases suggest that the freeze-out within the partnership context has two faces. The first method to invoke a freeze-out involves the dissolution powers afforded partnerships by statute in order to allow easy entrance and exit of partners. The second method involves the contracted-for expulsion clause that allows for the ousting of partners. Although some means of ouster or exit is obviously necessary for partnerships facing dissention, both the dissolution and expulsion tactics in some scenarios allow for the affectation of oppressive freeze-outs within the partnership context.

i. Freeze-Outs by Dissolution

In a default partnership-at-will, dissolution and ease-of-exit provide obviously useful mechanisms whereby a wealthier partner or a group of partners acting as a majority might rid themselves of other partners. For example, any partner can affect a rudimentary freeze-out through utilization of their access to dissolution, by simply dissolving the partnership and then subsequently seeking to re-acquire it in the ensuing liquidation sale. By simply not including all of the partners in this re-acquisition, the more powerful partners can effectively remove those previous partners from their posts within the partnership.¹⁵⁸ Of course, both the partners who are targeted by the freeze-out and third parties will have an equal ability to compete for the enterprise's assets in the liquidation sale, and so the partners affecting the dissolution cannot be absolutely confident of the success of this tactic. The bidding process involved in the liquidation sale may at least ensure that the ousted partners receive a fair price for their interest.

There are some obvious situations in which freeze-outs of this ilk appear more oppressive. For example, where one wealthy faction has an obviously large pecuniary advantage over the partners it seeks to oust, it is unlikely that the poorer parties will be able to compete in the bidding-war for the partnership's assets. This scenario is exemplified by *Page v. Page*, where two brothers had begun a business supplying linens in California.¹⁵⁹ Business was slow at first, and one brother lent money to the partnership via another business which he owned.¹⁶⁰ The linen business became profitable, however, when the Vandenburg Air Force Base was established

158. See Franklin A. Gevurtz, *Preventing Partnership Freeze-Outs*, 40 MERCER L. REV. 535, 540-41 (1989).

159. 359 P.2d 41 (Cal. 1961) (en banc).

160. *Id.* at 43-44.

nearby.¹⁶¹ Soon after, the wealthier brother sued for a declaration of his right to dissolve the partnership at will, and the poorer Page argued that his brother was attempting a freeze-out, as he would gain a hefty pecuniary advantage by crediting his bid against the debt that the Page partnership owed his other company.¹⁶²

Another scenario in which the freeze-out by dissolution might result in an unfair result for minority partners involves intangibles necessary to successfully run a business that are not accounted for in the liquidation of the business's assets. For example, when many professional partnerships dissolve, partners must individually compete for the partnership's clients. Without the clients, the liquidated assets of the partnership become virtually useless in engendering future profit, so some partners might affectively freeze-out others if they can better attract the former clients of the partnership.¹⁶³

ii. Freeze-Outs by Expulsion of Partners: Directly Pitting the Fiduciary Duty against the Contract

Within partnership law, partners are allowed a great deal of flexibility in pre-determining the terms of their personalized contract.¹⁶⁴ Therefore, as the dissolution and liquidation measures provided by statute are often cumbersome and complicated, many partnerships choose to contract out of liquidations at will. To do this, many enterprisers entering into a partnership will

161. *Id.*

162. *Id.*

163. *See, e.g.,* Smith v. Bull, 325 P.2d 463 (Cal. 1958) (in which one partner managed to take the one major client of an advertising partnership).

164. *See, e.g.,* Schwartz, *supra* note 156, at 6 (“Partnership law is unique in that it allows the partners to control many of the terms of their relationship; the statutory rules are for the most part merely default provisions”).

include an expulsion clause that allows for a prescribed process by which partners acting in through majority may oust other partners when and if dissention develops. A survey of cases concerning expulsions shows that the precise terms of expulsion clauses vary widely. Some clauses provide that a majority of partners might expel partners for any reason at all or no reason whatsoever, while other clauses set very specific limitations on the circumstances in which an expulsion is allowed.¹⁶⁵

Opportunity is ample for partners acting as a majority to actuate a freeze-out through expulsion clauses. Such oppressive uses of expulsion clauses pit contract directly against fiduciary duties in partnerships. Contractarians argue that, as all enterprisers must have agreed beforehand to the expulsion clause, they can not claim to be ambushed when it is used to expel them from their position as a partner. Fiduciarians argue, however, that an expulsion may wrongfully and oppressively violate the fiduciary duties between partners even if a majority of partners is authorized by an expulsion clause to expel a minority partner in the circumstances.¹⁶⁶ So, although fiduciarians recognize the likely necessity for a contract within a partnership, they believe that “it is a special kind of contract, since an agent is not merely a promisor or a promisee but is also a fiduciary.”¹⁶⁷ There is, then, a fiduciary core that is inherent and immutable within every partnership arrangement. Although partnerships normally involve a contract, that contract

165. See, e.g., *Holman v. Coie*, 522 P.2d 515, 521 (Wash. Ct. App. 1974) (allowing expulsion for any reason at all, so long as agreed to by a majority of partners); see also *Millet v. Slocum*, 167 N.Y.S.2d 136, 140 (N.Y.A.D. 1957) (making expulsion available only on grounds of “incompatibility”).

166. See Schwartz, *supra* note 156, at 6 (“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”).

167. Restatement (Second) of Agency; ch. 13, top. 1, introductory cmt. (1958).

can not infringe upon the fiduciary core of the partnership arrangement. If it does, it should not be enforced.

To explain why contractual clauses should not preempt the imposition of fiduciary duties within partnerships, it is helpful to again use the social responsibility theory as a lens through which to examine the relationships involved within the enterprise. The partnership relationship, like the shareholder relationship within close corporations, involves presumption of a great deal of trust and loyalty. Such relationships of trust and loyalty (fiduciary by definition) mean that expulsion clauses within partnerships are subject to the same limitations on effective contracting provisions as were discussed within the close corporation context. Many partners, because of that trust, will not anticipate the ways in which an expulsion clause might be used in an oppressive manner by their partners. Also, partners may hesitate to protest potentially harmful contract clauses because for fear of the possibility of bruising their relationship with their fellow enterprisers. Obviously, the best way to prevent freeze-outs by expulsion is to restrict the expulsion power to limited scenarios in which it would be justly and deservedly applied. However, it is difficult (if not impossible) to foresee all situations in which an expulsion clause may be necessarily and equitably exercised, and so partners may opt to include general expulsion clauses, trusting that these will not be used inequitably (and possibly later suffering because of such trust).¹⁶⁸ So, again, the very relationships that mandate the imposition of fiduciary duties are the same relationships that limit the effectiveness of contracts.

Freeze-outs in the partnership context and freeze-outs in the close corporate context differ in that, arguably, partners are better protected from being robbed of their fair share of the venture

168. See Moll, *supra* note 41, at 913 (“In light of the countless ways in which oppressive conduct can occur, it is quite difficult to foresee all (if not most) of the situations that may require contractual protection”).

than shareholders in the close corporate context. The Uniform Partnership Act (UPA) provides that expelled partners are entitled to receive a fair value for their interest in the partnership upon their expulsion.¹⁶⁹ It may be argued that because of this entitlement, the oppression doctrine is not as necessary in the partnership context as it is in the close-corporate context. However, the UPA provision cannot give full compensation to an ousted partner. For example, expelled partners will lose all value that they would have gained through continued association with the partnership.¹⁷⁰ Also, expulsion from professional partnerships often results in severe reputational damages to the ousted partner.¹⁷¹ Clearly, ousters are also likely to levy an additional emotional tax on any partner who is suddenly exiled from his partnership and his profession. For all of these reasons, courts should apply judicial review of potential partnership freeze-outs in order to assure that expulsions are only being affected through equitable means and with just cause.

B. Judicial Response to Oppression within Partnerships: The Twin Faith Tests

“For a majority of partners to say We do not care what one partner may say, we, being the majority, will do what we please, is, I apprehend what this Court will not allow.”
—Lord Eldon¹⁷²

Judicial efforts to combat oppressive freeze-outs within partnerships have met with varying degrees of success and acceptance. Some courts have attempted to eliminate oppression by implementing rules targeting specific types of freeze-outs. For example, to prevent the

169. UPA § 38(1) (1914).

170. See, e.g., Larry E. Ribstein, *Law Partner Expulsion*, 55 BUS. LAW. 845, 866 (2000) (“[T]he [expelled] partner can expect not to be compensated fully for her lost ability to continue as a partner in the firm. This comports with the function of expulsion as a disciplinary device and the high costs and low benefits of judicial second-guessing of the expulsion doctrine”).

171. *Id.* at 849 (discussing the reputational damages and other damages associated with expulsions of lawyers from law firms).

172. *Const. v. Harris*, 37 Eng. Rep. 1191, 1202 (1824).

freeze-out by statutory dissolution, courts might refuse to allow any partner to bid on the partnership's assets in the liquidation sale unless they have been expressly authorized to do so by their contract.¹⁷³ This rule seems too rigid, as noted by one scholar, equating it to "Solomon's famous bluff."¹⁷⁴ Also, some courts have simply refused to allow expulsions to result in a substantial forfeiture of the partner's interest.¹⁷⁵

The fiduciary duty arguably affords courts with the simplest and most flexible tool to review potentially oppressive freeze-outs involving expulsions within partnerships. Because of the frequently obvious necessity for expulsion powers within partnerships, courts generally will enforce any expulsion, so long as it was in accordance with the expulsion clause provided in the partnership agreement.¹⁷⁶ Courts have, however, slightly limited the breadth of enforceable expulsion clauses through the fiduciary duties of loyalty and care, interpreting such duties to require that an expulsion provision be either subject to a good faith requirement, or, alternatively, free of evidence of bad faith. These two requirements, although similar, lead courts to employ two very different tests.

i. The Test for Good Faith

173. See, e.g., *Rowell v. Rowell*, 99 N.W. 473 (Wis. 1904) (refusing to allow one partner to acquire all of the previous partnership property in a transfer).

174. *Gevurtz*, *supra* note 48, at 519. But, see *Mandell v. Centrum Frontier Corp.*, 407 N.E.2d 821, 832 (Ill. Ct. App. 1980) (offering a more practical version of this rule by simply barring any previous partners from acquiring partnership property for an insufficient price at a liquidation sale).

175. See *Jones v. Chester*, 363 S.W.2d 150, 157 (Tex. Civ. App. 1962, writ ref'd n.r.e.) (refusing to enforce a liquidated damages provision that unreasonably and disproportionately affected a partner's interest after he was involuntarily removed from the firm).

176. See, e.g., Donald James Nettles, *Do we Really Need Expulsion Procedures in Partnership Agreements: The Inadequacies of Partnership Law as it Relates to Law Partnerships*, 25 J. LEGAL PROF. 209, 213 ("Under UPA and its progeny of cases, it would seem that . . . a partner can be expelled for almost any reason as long as the expulsion is exercised pursuant to a valid partnership agreement").

Through the good faith requirement, courts generally require that the remaining partners be able to present a legitimate business purpose for the expulsion of any partner.¹⁷⁷ The test applied by courts under this requirement is very similar to the fiduciary duty's application within close corporations. In both, it is necessary to show a legitimate business purpose in order for a court to find that the fiduciary duty between partners or shareholders was not breached. Application in these contexts differs, however, in that, if a partnership can show a valid business purpose for the expulsion, that evidence alone is sufficient to cause the courts to enforce the expulsion, whereas majority shareholders within close corporations must additionally show that there are no other less oppressive means through which to effectuate the same business purpose. This difference in the fiduciary doctrine between partnerships and close corporations is likely explained by the more compelling need for an expulsion power within partnerships and the greater protections afforded in the partnership context to assure that expelled partners receive just compensation for their interest in the venture.

This test is limited by the grounds upon which the court may be willing to accept what constitutes a legitimate business purpose. More liberal definitions of business purposes might render this test virtually inadequate.¹⁷⁸ This test appears further inadequate when the partners provide in an expulsion clause that the expulsion can be affected by a majority “without cause.” Courts are not in agreement about the extent to which they should enforce or review such clauses in this context, but, as it is totally counter-intuitive to require cause to be shown for a clause

177. See Schwartz, *supra* note 156, at 5 (“[C]ourts have read the duty of good faith to generally require that expulsion be justified by a legitimate business purpose”). See also *Gigax v. Repka*, 615 N.E.2d 644, 650 (Ohio Ct. App. 1992) (applying this rule to find a breach of the fiduciary duty).

178. See *Waite on Behalf of Bretton Woods Acquisition Co. v. Sylvester*, 560 A.2d 619 (N.H. 1989) (holding that a “schism” constituted a legitimate business purpose in a partnership expulsion).

waiving a cause requirement, courts facing this dilemma will have to ultimately decide between either allowing parties to contract around the fiduciary duty in this manner or refusing to enforce a contract clause that allows parties to opt out of fiduciary duties.¹⁷⁹

ii. The Test for Bad Faith

The requirement that an expulsion be free of bad faith allows courts to consider any evidence of bad faith in partnership expulsions when deciding whether they are unenforceable breaches of the fiduciary duty. The most common reason that courts will find a case unenforceable for bad faith is when evidence shows that the majority partners expelled their minority co-partners for their own financial self-gain.¹⁸⁰ There are arguably endless additional reasons that a court could find evidence of bad faith in an expulsion, including expulsion for racist or sexist reasons, expulsion because of age, or expulsion for personal spite.¹⁸¹ Some courts have determined to afford protection from oppression in these contexts by refusing to establish a set definition for bad faith, and to instead examine each expulsion on a case-by-case basis to determine whether evidence of bad faith exists.¹⁸²

Although the bad faith test enjoys the benefits of a more general scope than does its good faith twin, it is subject to similar setbacks. A court substantially limits the application of the test

179. See *Gevurtz*, *supra* note 48, at 521 (“There is uncertainty in the cases ... about the extent to which the exercise of an expulsion power is subject to a good faith limit”).

180. See *Schwartz*, *supra* note 156, at 4 (“[Some courts] permit ... expulsion unless the remaining partners used the mechanism to wrongfully promote their own economic interests”). See also *Nettles*, *supra* note 174, at 213 (calling the finding of bad faith use of an expulsion for self-gain “the lone exception to [the] at-will view of partnerships”). *Holman v. Coie*, 522 P.2d 515, 523 (Wash. Ct. App. 1974) (employing this test to find that an expulsion was affected in bad faith).

181. See *Schwartz*, *supra* note 156, at 11-12 (arguing that “it seems that even the most restrictive definition of good faith would forbid expulsion if an ousted partner could show [these types of] motivations”).

182. See, e.g., *Winston and Strawn v. Nosal*, 664 N.E.2d 239, 243 (Ill. App. Ct. 1996).

if it supplies a restrictive definition of bad faith.¹⁸³ Also, the bad faith test is as vulnerable to similarly crippling contractual affronts as the good faith test if it is faced with an expulsion clause that authorizes the majority partners to affect an expulsion “for any reason.” When faced with this expulsion clause, courts would have to again decide between either allowing the parties to contract around fiduciary duties or using the fiduciary duty to find the contract clause unenforceable.

iii. Locating the Twin Faith Tests within the Fiduciary Duty Doctrine

Although a general appeal to a good faith requirement is also a tool provided within contract law, the “good faith” requirement as applied by courts to prevent oppression of minority partners is an application of fiduciary, and not contractual, principles.¹⁸⁴ The fiduciary good faith requirement is derivative of the fiduciary duty of loyalty.¹⁸⁵ This duty of loyalty is seen as “imposing dual requirements on partners. One serves to protect the business of the partnership. The other ... protects the partners themselves.”¹⁸⁶ The derivation of the general fiduciary good faith requirement from the two-fold role of the fiduciary duty of loyalty supplies a perfect explanation for why the two different tests of good faith have emerged in case law. The “good faith test” addresses the first requirement of the fiduciary duty of loyalty – to protect the business

183. See *Holman*, 22 P.2d 515 at 523 (restricting bad faith findings to cases involving economic predation).

184. See, e.g., Schwartz, *supra* note 156, at 4 (“[C]ourts have been fairly consistent in that they have viewed good faith from a fiduciary duty perspective (though some ... cases have included brief analyses of the contractual duty of good faith in addition to their fiduciary duty discussions).”). See also *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).

185. See Schwartz, *supra* note 156, at 3 (“Traditionally, good faith [as applied within the context of partnership expulsions] has been conceptualized as a component of the fiduciary duty of loyalty”).

186. *Id.*

of the partnership – by making sure that majority partners are acting in the best interests of the firm. The “bad faith test” addresses the second requirement of the fiduciary duty of loyalty – the protection of individual partners – by assuring that partners are treating each other with equity. So, courts should employ both of these tests in order to best determine whether the fiduciary duty of loyalty has been breached. However, by using an expulsion clause that provides majority partners a means to expel minority partners “for any reason” and “without cause,” majority partners can effectively contract around both of the twin faith tests, allowing them to completely opt-out of the fiduciary duty of loyalty.¹⁸⁷ As the fiduciary duty of loyalty is an integral and essential component in relationships between partners, courts should seek to preserve it in its entirety by refusing to enforce expulsion clauses that contract around either of the twin faith tests.

C. A Case Study of Oppression in Law Firms: Contractors Oppressed by Contract

“I had been the author of unalterable evils; and I live in daily fear, lest the monster whom I created should perpetrate some new wickedness.”
- Dr. Frankenstein¹⁸⁸

Contractarians argue that, as fiduciary duties are nothing more than implied contract terms, parties should be allowed to limit or eliminate their fiduciary duties through express provisions in their contract. Strict contractarian states, such as Delaware, adopt this reasoning in holding that they will not afford the common law protections of fiduciary duties to victims of

187. Critics may argue that such an expulsion clause would never be accepted by all of the partners. However, it may be easier than it seems. As a roughly analogous example, a majority of students in my section were surprised to learn, when our Contracts professor read aloud portions of our dorm contracts with Harvard Law School, that the contracts we had signed allowed HLS employees to enter our bedrooms “at any time” and “for any reason.”

188. MARY SHELLY, FRANKENSTEIN, OR THE MODERN PROMETHEUS 92 (1818).

freeze-outs when those people had the means to protect themselves by contract. Their holding here assumes that parties are both capable of adequately protecting themselves by contract and that this protection is then sufficient means for a minority interest-holder to protect his stake in an enterprise from oppressive freeze-outs.

A case study of expulsion within law firm partnerships offers a useful test of this contractarian theory. Lawyers arguably are able to contract better than anyone. They have been schooled in the nuances of contract and have been lectured on the possibilities for oppression by expulsion. They are familiar with the freeze-out, have likely read *Page v. Page*. If it is true, as the contractarians claim, that fiduciary duties are unnecessary because an informed and capable party to a contract should be able to adequately protect his interests through contractual means, then we should consequently see little evidence of oppression within incidence of law firm expulsions.

i. Introduction to the Problem

Law firms offer a poignant picture of the way in which the law and economics theory has changed the face of business through its contractarian extension. When Cardozo described the “punctilio of an honor” as the fiduciary standard between partners, law firm partnerships operated in a much different way. As described by one scholar, “Under the older, more traditional conception of lawyer affiliation, withdrawal or expulsion was unthinkable: Once a lawyer became a partner it was assumed that he . . . stayed with the firm until death or retirement. The firm cleaved to the lawyer over the same course.”¹⁸⁹ Then, a law partner’s position was

189. Geoffrey C. Hazard, Jr., *The Underlying Causes of Withdrawal and Expulsion of Partners from Law Firms*, 55 WASH. & LEE L. REV. 1073.

“similar to that of a tenured professor who cannot be expelled except for serious misconduct.”¹⁹⁰

After the virtual usurpation of legal theory by the law and economics school, the valuable relationship of loyalty and trust characteristic of the traditional firm has been replaced by a *valuated* relationship of earning potential.¹⁹¹ This modern conception of a firm’s partners as expendable when expensive is best evidenced recently by many firms’ callous culling en masse of less profitable partners in order to improve firm profitability.¹⁹² This has resulted in a healthy yield of case law in which ousted partners challenge the expulsion practices of their firms through general appeals to the fiduciary duty. Such case law suggests that, contrary to the contractarian contention that through the manipulation of abusive expulsion ploys, the masters of contract themselves can be as oppressed as their lay counterparts within other partnership settings by the same type of freeze-outs.

ii. Law Firm Expulsions that Fail the Good Faith Test

In one strain of law firm expulsion cases, courts have employed the good faith test to the expulsion, requiring that the firm show a legitimate business purpose for the expulsion. One commentator has advocated, given the extreme reputational damages an expelled lawyer will

190. Margaret Kline Kirkpatrick, *Partners Dumping Partners: Business Before Ethics in Bohatch v. Butler & Binion*, 83 MINN. L. REV. 1767, 1780 (1999).

191. See JEFFREY S. STERN & REGINA E. ROMAN, ETHICAL LAWYERING IN MASSACHUSETTS §7.7.1 (“In an era of heightened competition, mergers and increased focus on ‘productivity,’ it was inevitable that courts would come to deal with the once unthinkable phenomenon of partners being forced out of law firms”).

192. See, e.g., *Cadwalader, Wickersham & Taft v. Beasley*, 728 So.2d 253 (Fla. Dist. Ct. App. 1998) (in which majority partners within a large firm, through a program dubbed “Project Right Size,” successfully sought to improve their per partner profitability by expelling minority partners in less profitable branches).

suffer in his career, that the courts limit acceptable business purposes to those entailing a “collective purpose.”¹⁹³

Winston v. Nosal provides an example of a law firm expulsion case that used this reasoning to find that a triable issue existed as to whether the expulsion included a breach of fiduciary good faith.¹⁹⁴ In that case, Chester Nosal claimed that he was expelled from the law firm in retaliation for his persistent requests to be allowed to view the partnership’s accounting and clerical records. He provided evidence that those records would reveal questionable billing practices and secret self-dealing of the firm’s management committee (who were instrumental in his expulsion). The Court held that the good faith duties partners owe to their business would bar the expulsion of a partner in order to protect self-dealing and misconduct by the managing partners, as this purpose “conferred no benefit on the partnership as a whole.”¹⁹⁵

iii. Law Firm Expulsions that Fail the Bad Faith Test

A second breed of law partner expulsion cases provides review through the bad faith test, usually finding a breach of the fiduciary duty where the expulsion was affected solely for the economic self-gain of the remaining partners. In *Cadwalader, Wickersham & Taft v. Beasley*, a Florida court applying New York law employed the bad faith test to find that the expulsion violated the fiduciary duty of good faith where its primary motive was to increase the

193. See Allen W. Vestal, *Law Partner Expulsions*, 55 WASH. & LEE L. REV. 1083, 1126-27, 1133 (1998).

194. 664 N.E.2d 239, 246 (Ill. App. Ct. 1996).

195. Ribstein, *supra* note 168, at 873.

compensation of other partners.¹⁹⁶ In that case, Beasley, an “extraordinary rainmaker and a skilled litigator,” was a partner in a less profitable Palm Beach branch of the New York based law firm.¹⁹⁷ A group of “younger, more productive” partners within the New York branch threatened to leave the firm if their compensation was not increased.¹⁹⁸ They convinced management that in order for the firm to stay competitive- providing higher salaries for the remaining partners- it would need to expel certain partners. As a result, the management committee held a secret meeting in which, through a plan dubbed “Project Right Size,” every partner in the Palm Beach branch was targeted for expulsion.¹⁹⁹ At the same time that the firm made secret plans to close the Palm Beach office, significant bonuses were paid to a number of the partners instrumental in “Project Right Size.”²⁰⁰ The Court held that Beasley’s expulsion was a breach of the good faith fiduciary duties between partners, stating that the expulsion “was done for the express purpose of producing greater profits for the remaining partners” and that the clandestine way in which the expulsion was conducted “cannot be said to be honorable, much less comport with ‘the punctilio of an honor’.”²⁰¹

iv. Contract as Limiting the Twin Faith Fiduciary Test Tools within Law Firms

196. Cadwalader, *supra* note 190; *cf.* Heller v. Pillsbury Madison & Sutro, 58 Cal. Rptr. 2d 336, 347 (Cal. Ct. App. 1996) (holding that although a partner’s expulsion will increase all of the partner’s profit shares, this does not evidence economic predation when the partner was earning toward the low range of the firm’s compensation rate and the increase-per-partner afforded by his expulsion was insubstantial).

197. *No. 94-8646AJ*, 1996 WL 438777, at *1.

198. *Id.* at *2.

199. *Id.* at *3.

200. *Id.* at *7.

201. *Id.* at *6, *See also* Starr v. Fordham, 420 Mass. 178, 648 N.E.2d 1261 (1995) (for a similar holding).

Notably, in *Cadwalader*, the partnership contract had no express expulsion provision. In cases which involve contracts that include a broad expulsion clause, courts are much less likely to find that a breach of the fiduciary duty occurred, even when the expulsion was accomplished with clear evidence of bad faith through economic predation or other means.²⁰² In fact, “it is now quite unremarkable for courts to accord substantial teleological deference to controlling factions within a partnership who invoke a provision in a partnership agreement to expel one of their counterparts.”²⁰³ This deference to contract, however, provides highly conducive circumstances for the freeze-out, affording majority partners an easy means to abuse their fiduciary duties with oppressive expulsions. For example, in *Lawlis v. Kightlinger & Gray*, an ousted law firm partner presented a case similar to Beasley’s by providing evidence that he was eliminated solely to improve the firms’ “lawyer to partner ratio,” thus raising profits per partner.²⁰⁴ In *Lawlis*, however, the partnership contract provided an expulsion clause permitting a partner to be expelled by “(a) two-thirds (2/3) majority of the Senior Partners, at any time.”²⁰⁵ Because of the inclusion of this clause, the court held that the firm was within its legal rights to expel Lawlis “without stating a reason or cause pursuant to the partnership agreement.”²⁰⁶ Discrepantly, in dicta, the Court stated that expulsions made “in bad faith or for a predatory purpose” are in violation of the good faith fiduciary duties of partners.²⁰⁷ This suggests that,

202. See Ribstein, *supra* note 170, at 869. (“The courts may cite the existence of fiduciary duties ... however, when it comes to deciding cases, there is strong reason to believe that courts will enforce the expulsion agreements”).

203. Talley, *supra* note 2, at 1007

204. 562 N.E.2d 435 (Ind. App. 4 Dist. 1990).

205. *Id.* at 439-40.

206. *Id.* at 442.

207. *Id.* at 440.

even though the court recognized the fiduciary violations that were evidenced by the facts immediately before them in *Lawlis*, because the parties had cleverly contracted around the fiduciary tests, its hands were tied.

Bohatch v. Butler & Binion presents another example of the crushing effect that contract can have on a court's capability to test for breaches of fiduciary duties. In *Bohatch*, a law partner was expelled after reporting evidence of her colleagues' ethical violations through over-billing.²⁰⁸ Although the court admitted that Bohatch was required to disclose the over-billing by the District of Columbia's Code of Professional Responsibility, and that "the relationship between partners is fiduciary in character," the Texas Court held that, because she was expelled pursuant to the clause in her contract, and "partners may choose with whom they wish to be associated," there was no evidence of bad faith in the expulsion.²⁰⁹

Though all the previous examples of ways in which contract may limit the fiduciary tests within law firm expulsions should raise concerns that the contract can indeed be effectively used to abet an oppressive freeze-out, perhaps the most cautionary example is suggested in the dicta of *Cadwalader*. Though Beasley's expulsion was found oppressive by reason of a breach of the fiduciary duty, the court went on to suggest that, had the majority partners merely passed an amendment to the partnership agreement in which they provided themselves an appropriate exclusion clause giving them the power to expel partners through "Project Right Size," they could have executed the same expulsion with impunity.²¹⁰ This suggests not only that, but for a contract clause, the court could condone the oppressive conduct in this case, but also that

208. 977 S.W.2d 543 (Tex. 1998).

209. *Id.* at 545.

210. *No. 94-8646AJ*, 1996 WL 438777, at *6.

majority partners can – by providing that contracts may be amended through a majority vote – easily affect an untouchable freeze-out scheme to oust their minority counterparts. If, as this suggests, a court would enforce an expulsion clause that was created in this manner without question of the fiduciary duty, minority partners could be expelled by a clause to which they never actually agreed.

Clearly, a review of cases involving expelled law firm partners suggests that even lawyers – who have been schooled in expert contracting – can fall victim to freeze-outs affected through contractually defined expulsion provisions.²¹¹ This suggests that even informed and capable contractors can not provide for their own complete and absolute protection through a contract. As such, courts must assure that all partners are afforded the protections of mandatory fiduciary duties, and should refuse to enforce contract clauses that undermine or contract around those duties.

D. Implications of the Adoption of the Revised Uniform Partnership Act

Although the contract's warped utility in facilitating minority oppression suggests that fiduciary duties should be strengthened relative to contractual provisions, the statutory trend is in the opposite direction.²¹²

The fiduciary doctrine within partnerships developed through common law within the limited guidance provided by the Uniform Partnership Act (UPA), which, ironically, does not

211. For additional reasons suggesting law partners inability to fully and effectively contract, *see generally* Hillman, *supra* note 9.

212. *See, gen.*, Matheson & Maler, *supra* note 7, at 1616 (“In the context of the noncorporate business entity, the movement toward contractually controlling liability has been reflected in the enactment of the Revised Uniform Partnership Act (RUPA) and the Uniform Limited Liability Company Act (ULLCA)”).

contain any explicit definition of fiduciary duties.²¹³ Nowhere within the UPA is the duty of loyalty- the court's most favored means to combat oppression- mentioned.²¹⁴ Arguably, it is *because* the UPA provides no definition of the fiduciary duty that the fiduciary doctrine has been so useful in combating oppressive freeze-outs. The duties are malleable, and this makes them powerful, allowing courts to call upon them to consistently strike down the freeze-out in all of its various forms. Within common law, courts utilized the duty of loyalty to develop an arsenal with which to fight unjust, oppressive, and inequitable actions towards minority interest-holders. In its entirety, as evidenced throughout this paper, this arsenal is quite capable of quelling oppressive freeze-outs. However, few jurisdictions afforded themselves the arsenal in its entirety, leading to frustration among enterprisers as to the uncertain applications of the fiduciary duty of loyalty. This bred widespread confusion among courts over the extent to which the fiduciary duties could be varied by consensual agreement among the parties.²¹⁵ After all, it appeared that it was the malleable nature of the fiduciary duty that allowed courts to use it so effectively. How could courts then – when asked whether partners could alter the duties – deny that they were malleable?

The Revised Uniform Partnership Act (RUPA) opted for a compromise within this conflict by “relaxing the immutability of fiduciary duties [in recognition of] a limited power of the partnership agreement to prescribe standards for measuring compliance with fiduciary

213. See Callison, *supra* note 49, at 113 (“The UPA, which was enacted in substantially identical form in all states (other than Louisiana) ... does not contain a definitive statement of partner fiduciary duties. Instead, section 9(1) of the UPA states that agency law principles, presumably including fiduciary principles derived from agency law, apply to partnerships.”).

214. See Haynes, *supra* note 3, at 434.

215. *Id.* at 447 (“There has always been a tension regarding the extent to which a partner’s fiduciary duty of loyalty can be varied by agreement, as contrasted with the other partners’ consent to a particular and known duty”).

duties.”²¹⁶ As to the fiduciary duty’s ability to repel the freeze-out, however, this “compromise” has resulted in a complete slaughter.

Although the RUPA provides that “[a] partnership agreement may not eliminate the duty of loyalty...,” it confines the duty of loyalty to a tripartite definition.²¹⁷ Expulsion without a valid business cause would not constitute breach under any part of this definition, thus rendering the common law good faith test obsolete. The RUPA goes on to abrogate the bad faith test as well by audaciously providing that “a partner does not violate a duty or obligation under this [Revised Act] or under the partnership agreement merely because the partner’s conduct furthers the partner’s own interest.”²¹⁸ As the RUPA was intended “to displace, and not merely supplement, the common law,” it confines the power of courts to refuse to enforce a contractual clause that breaches the fiduciary duty.²¹⁹ Therefore, by annihilating both the good and bad faith tests, the RUPA robs the court of the tools by which it can find an expulsion oppressive. In its current form, therefore, the RUPA sanctions oppression by contract, further “streamline[ing] expulsions by allowing partners to define ... the standard by which the good faith of an expulsion will be measured.”²²⁰ For contractarians, the RUPA represents a great triumph, but,

216. Talley, *supra* note 2, at 1007.

217. Revised Unif. P’ship Act app., 6 U.L.A. 5, §404(b), at 143, Part I (1997).

218. *Id.* at §404(f), at 143, Part I.

219. Allan W. Vestal, *Fundamental Contractarian Error in the Revised Uniform Partnership Act of 1992*, 73 B.U. L. REV. 523, 532 (1993).

220. Robert W. Hillman, *Law, Culture, and the Lore of Partnership: Of Entrepreneurs, Accountability, and the Evolving Status of Partners*, 40 WAKE FOREST L. REV. 793, 814 (2005).

because contract allows for minority oppression through freeze-outs within business entities, courts should be extremely wary of adoption it in its current form.²²¹

Although dissention is common, “even when divisions within a partnership develop and a control coalition emerges, a measure of respect must be accorded to the position of minority partners simply by virtue of their status as partners within the firm.”²²² So, “while partners are free to vary many aspects of their relationship inter se, . . . they are not free to destroy its fiduciary character.”²²³ It appears, however, that courts are allowing them to do just that by contractually eliminating the fiduciary duty of loyalty, opening the door to expulsionary freeze-outs and inviting oppression into the sacred fiduciary relationship. To reify strict standards of loyalty and care within business relationships, demanding more than just the morals of the marketplace, courts must resurrect a strict and immutable fiduciary duty of loyalty. To define business morality by contract assures that it will often be compromised with no consequences. This is an outcome result that should trouble all of society, relative especially to practices such as law and medicine, callings that society must depend on to be ethical.

The need for such an immutable duty is exemplified by recent statutory initiatives to define and confine the fiduciary duty of loyalty. Such initiatives result in destruction of common law methods that courts have created to combat oppressive freeze-outs, leaving violated minority interest holders (pardon the pun) out in the cold.

221. See Callison, *supra* note 49, at 164 (“I think the contractarian premise is fundamentally flawed when applied to partnership law and, because RUPA adopts that premise, partnership law under RUPA also is flawed”).

222. See Hillman, *supra* note 220, at 797.

223. Labovitz v. Dolan, 545 N.E.2d 304, 310 (Ill. App. 1 Dist. 1989) (*quoting* Saballus v. Timke, 460 N.E.2d 755, 760 (Ill. App. 1 Dist. 1984)).

Part 4: Oppression within the LLC

The contractarians' pet form of private business ordering, and the most recently established, is the limited liability company. The LLC presents perhaps the most urgent case for the need to impose strict fiduciary duties to prevent oppression. It may also be the most important quantitatively, as the LLC is being rapidly embraced by enterprisers across the country, and has quickly become "the preferred choice for many businesses."²²⁴ The LLC is a hybrid of corporate and partnership law, and "its combination of limited liability for the owners and partnership-style flow-through tax treatment" makes it an especially attractive option.²²⁵ However, being a hybrid, it contains the dangerous means discussed previously in both the close corporation and partnership contexts for a majority to freeze out minority members. This atmosphere of double freeze-out jeopardy in the LLC is compounded by courts' willingness to enforce members' contracted-for agreements concerning almost any of their terms.²²⁶ Such a ripe environment for oppression is desperately in need of immutable fiduciary duty principles to protect minority members.

A. The Claws of the Creature of Contract

One of the most attractive aspects of the LLC to enterprisers is the "extensive freedom to contractually arrange the business."²²⁷ Most LLC statutes go so far as to announce that "the

224. Moll, *supra* note 41, at 886 ("[U]se of the LLC has exploded. Over the 1992-1996 time period, for example, new registrations for corporations and limited partnerships increased by 13 percent and 15 percent").

225. Gevurtz, *supra* note 48, at 497.

226. Robert B. Keatinge, *New Gang in Town*, BUS. LAW TODAY, Mar./Apr. 1995, at 5 ("To a far greater extent than is true of the corporation, an LLC may be organized in accordance with the agreement of the members").

227. Moll, *supra* note 41, at 885.

[LLC's] operating agreement may establish any rules that the members desire, with the statutes providing 'default rules' that govern the LLC where members have not provided otherwise."²²⁸

This has led scholars to refer to the LLC as a "creature of contract."²²⁹

Enterprisers within an LLC, however, suffer from the same limitations to effective contracting as those within partnerships and close corporations.²³⁰ Similar to the close corporation, the LLC is normally made up of a small group of people who have close relationships and do not see the need for extensive contracting to provide for their protection in case of dissent.²³¹ Also, empirical evidence established by one scholar indicates that many LLC operating agreements are "based on form agreements that are not extensively negotiated."²³² Although the contractarian bent of the LLC is attractive for providing predictability and certainty, these unavoidable limitations in the LLC organizing agreement have been used to create a vehicle for oppression of minority members. Professor Moll asserts that majority members in an LLC may easily affect a freeze-out similar to those discussed within the close corporate context because the LLC entity includes the same "seeds of oppression" that

228. *Id.* at 920.

229. *See, e.g.*, Miller, *supra* note 3, at 1628 ("To what extent will courts intervene to impose mandatory standards to curb abusive conduct, notwithstanding the fact that the LLC is designed to be a creature of private contracting?").

230. *See* Moll, *supra* note 41, at 953 ("Even if a minority member of an LLC did recognize the utility of advance planning for dissension the inability to foresee all (if not most) of the situations that may require contractual protection can erode the effectiveness of any planning that does occur. Regardless of the business structure, in other words, the same limitations of human foresight exist, and the same incomplete contracting is likely").

231. *See* Dennis S. Karjala, *Planning Problems in the Limited Liability Company*, 73 WASH. U. L.Q. 455, 477 (1995) ("Many small businesses ... will elect not to assume the expense of negotiating, and hiring an attorney to draft, a carefully worded operating agreement").

232. *See* Sandra K. Miller, *A New Direction for LLC Research in a Contractarian Legal Environment*, 76 S. CAL. L. REV. 351, 357 (2003); *see id.* at 422 (for empirical data concerning LLC operating agreements).

exist within close corporations.²³³ These common traits include “the lack of exit rights, the norm of majority rule, the deference to the business judgment rule, and the absence of advance planning.”²³⁴ As Professor Moll concludes, when all of these traits are present, “based on close corporation experience, it is inevitable that some majority owners will abuse their control at the expense of minority owners.”²³⁵ The LLC’s operation in practice suggests that Professor Moll’s prediction is proving true, as “cases have arisen repeatedly in which majority-owners have attempted to remove or reduce the ownership percentages of their minority partners.”²³⁶ Also, majority members within the LLC can affect a partnership-like freeze-out by using an expulsion clause.²³⁷ Moreover, as many statutes allow an LLC member majority to amend the operating agreement at any time, LLC majorities are easily able to amend the agreement *for the sole purpose* of kicking out the minority.²³⁸

233. Moll, *supra* note 41, at 956-57; *see id.* at 925-26 (“Indeed, commentators have noted that the LLC is primarily used as a business structure for closely held ventures”).

234. Moll, *supra* note 41, at 896; *see id.* at 947 (“[Within the LLC] acting together ... a group of managers can routinely and systematically garner majority to outvote a minority owner-manager on issues that directly affect the minority’s ownership position. Where this power is exercised in an abusive fashion, an oppressive situation is present, as there is not ‘market exit’ through which the minority owner can escape the situation”).

235. Moll, *supra* note 41, at 956-57.

236. Miller, *supra* note 3, at 1612; *see also* VGS, Inc. v. Castiel, No. 17995, 2000 Del. Ch. LEXIS 122, *13-14 (Del. Ch. Aug. 31, 2000) (holding that a breach of fiduciary duties had occurred when a majority of members failed to notify the minority of a proposed merger); Lynch Multimedia Corp. v. Carson Communications, L.L.C., 102 F. Supp. 2d 1261, 1261-62 (D. Kan. 2000) (claiming that LLC member companies breached their fiduciary duty by purchasing competing franchises); Anest v. Audino, 773 N.E.2d 202, 210 (Ill. App. Ct. 2002) (holding that a majority member breached his fiduciary duty by not informing a minority member of an exclusive distributorship agreement offered to the LLC); Flippo v. CSC Assocs. III, 547 S.E.2d 216, 221-22 (Va. 2001) (holding that a member breached his fiduciary duty to another member when he transferred LLC assets out of the LLC in order to achieve estate planning goals).

237. *See* Gevurtz, *supra* note 48, at 536-37 (“A number of LLC statutes sanction provisions in the operating agreement ... that allow members to expel fellow members from the firm”).

238. *Id.* at 86 (providing a list of the states’ LLC statutes that allow amendments by a majority); *see also* Fine v. Bork, No. 010808586, 2002 Conn. Super. LEXIS 181, *2-4 (Conn. Super. Ct. Jan. 15, 2002) (for an example of a majority amending an expulsion clause in order to squeeze-out a minority).

Because of recurrent occurrences of oppression due to the insufficiencies of contract within the LLC, scholars argue that the fiduciary duty should be held superior to contractual clauses, such that clauses should not be enforced when they produce breaches of the fiduciary duties.²³⁹

B. The Statutory Stance of Fiduciary Duties within the LLC

Unlike corporation statutes, many state statutes governing the LLC have expressly addressed the concept of the fiduciary duty, but these statutes vary widely in their provisions.²⁴⁰ Some states have recognized that the LLC resembles the close corporation, and have thus explicitly provided that members within an LLC have fiduciary duties to one another, and to the company.²⁴¹ In these states, it would obviously be easier for a court to import, by analogy, the oppression doctrine, as the court could argue that its application was supported by statutory intent.²⁴² Indeed, some states seem to have already imported the close corporation's Donahue standard of fiduciary duties between shareholders to the LLC context, recognizing that members within the LLC are fiduciaries.²⁴³ The Uniform Limited Liability Company Act (ULLCA)

239. Miller, *supra* note 3, at 1652 (“[T]he continuing occurrence of predatory and exploitative patterns of conduct seen in the close corporation and the LLC settings illustrates the need for judicial flexibility and equitable concepts to combat conduct that violates fundamental notions of fair play”). See also Moll, *supra* note 41, at 896 (“the problem of oppression is ‘portable’ t the LLC context”).

240. See Miller, *supra* note 3, at 1624 (providing an overview of the ways in which statutory treatment of the fiduciary duty varies).

241. See Moll, *supra* note 41, at 966 (“Significantly, many of the [LLC] statutes explicitly indicate that fiduciary duties run to the individual members as well as the LLC entity”).

242. *Id.* (“[Statutes that provide that the fiduciary duty runs to members] make it easier for the oppression doctrine to ‘take root’ in the LLC context, as courts can use the statutory language to justify a more member-centered, rather than firm-centered, fiduciary duty analysis”).

243. *Id.* at n. 265 (providing a list of cases in which courts held that members are fiduciaries). See also Miller, *supra* note 3, at 1631 (“Chief Judge Cardozo’s admonishment that partners owe each other ‘the duty of the finest loyalty’ first permeated partnership law, then close corporation law. It is now beginning to color the development of LLC law as courts seek to establish a fiduciary core that is applicable to LLC participants”).

adopts the same limited provisions and obligations concerning the fiduciary duty as the RUPA, including an additional provision that members in an LLC who do not concurrently act as managers are not fiduciaries.²⁴⁴ As such, the ULLCA imports all of the dangers associated with the RUPA already discussed. These dangers are obviously compounded by the LLC's resemblance to a close corporation, as members have no ready market for which to sell their interest in the company and often lack the protections afforded partners in the event of an oppressive ouster. Additionally, as one commentator notes, the elimination of fiduciary duties for non-managing members "goes too far," arguing that close corporation principles should be imported instead.²⁴⁵

Even if the fiduciary duties are acknowledged, questions remain over the degree to which parties can modify the duties contractually.²⁴⁶ Delaware, predictably, is the most liberal on this front, providing in its statutes that its policy is to "give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements [allowing for] the member's or manager's or other person's duties and liabilities [to be] expanded or restricted by provisions in the limited liability company agreement."²⁴⁷ As a result, one scholar notes, "Some Delaware decisions have been so deferential to the parties' contracts that they create an impression that general partners and LLC members may substantially and materially restrict common law fiduciary duties."²⁴⁸ Such preeminence of contract, in light of the risks that

244. See Unif. Ltd. Liab. Co. Act § 104

245. Callison, *supra* note 49, at 163.

246. See Miller, *supra* note 3, at 1625 ("The statutes also vary in the extent to which they permit contractual modifications ... many LLC statutes even contain express restrictions on the right to contractually modify the member's or manager's standards of conduct...").

247. Del. Code Ann. tit. 6 § 8942 (West 1995 & Supp. 2003).

248. Miller, *supra* note 3, at 1636-37.

imperfect contracting poses to minority members, is sure to foster oppression within the LLC. Without the fiduciary duty to invoke, then, in some states minority members appear to be hopeless victims at the mercy of the claws of the creature of contract.

Conclusion

As discussed throughout this paper, “the problem of oppression is one involving the closely held business, not just the closely held corporation.”²⁴⁹ Moreover, within every private business milieu, allowing enterprisers to limit or eliminate their fiduciary duties through contract exacerbates that oppression, facilitating the freezing out of majority members by their minority counterparts. The contractarian might counter by claiming that when freeze-outs do occur, it is because the minority members did not adequately afford themselves of the contractual protections that were available to them. It was their fault. They “got what they bargained for.” However, it is becoming increasingly apparent that contractual protections are simply not enough. Even lawyers, who are trained in contract, are being frozen out through expulsion clauses, and within the LLC, where members are afforded a great deal of contractual freedom, oppression is rampant.

Reliance on the contract, alone, is insufficient. Courts must draw from legal theory beyond the contractarian doctrine to find guidance in combating oppression. The answer lies within the social responsibility theory that extols relationships: between co-workers, co-enterprisers, and co-habitants of this society. The immutable fiduciary duty envisioned by Cardozo and embraced within the close corporation addresses those relationships, commanding respect and reverence of the loyalty and trust that should be demanded of co-enterprisers; it is the

249. Matheson & Maler, *supra* note 7, at 661.

“resolution of the [oppression] conundrum ... applicable across business entity types.”²⁵⁰ A resurgence of Cardozo’s envisioned duties will not only empower courts with the means to afford protection to holders of minority interests throughout the spectrum of private business, but also affect a much-needed restoration of a moral mandate in the marketplace.

250. *Id.*