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Preventing Partnership Freeze-Outs

by Franklin A. Gevurtz*

I. INTRODUCTION

Considerable literature explores appropriate legal responses to freeze-outs in both public and closely held corporations.1 Writers, however, have paid relatively little attention to the same phenomenon in partnerships.2 The reason for this inattention is not entirely clear. Perhaps writers have viewed partnerships as an unimportant business entity. This view has always been questionable,3 and now is entirely untenable in light of recent

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3. As of 1983, more than 1,542,000 partnerships existed in the United States. The total amount of partnership assets in 1983 was over $886,993,000,000 and partnership income was...
tax code changes creating substantial incentives to operate in the partnership form.\(^4\) Alternately, the explanation may lie in an assumption that freeze-outs do not commonly occur in partnerships. Numerous reported decisions involving allegations of partnership freeze-outs\(^6\) effectively belie such an assumption. Finally, the assumption may exist among writers that courts have already issued satisfactory responses to partnership freeze-outs.\(^8\) A review of judicial decisions involving such freeze-outs yields, however, a number of circumstances in which courts are at odds over how to deal with the problem.\(^7\) In other cases, courts have been completely ineffective in preventing freeze-outs.\(^6\) In still other situations, judicial decisions may create more problems than they solve.\(^9\)

This article, therefore, explores approaches to prevent partnership freeze-outs. At the outset, it is important to be clear concerning what the term means—at least in its pejorative use as something that one should prevent. Giving this label to all efforts by partners to end their association with other partners, while still continuing the partnership business,\(^10\) may be accurate as a literalism, but is too broad for useful analysis. In a partnership, as in other relationships, occasions arise in which the parties are no longer able to get along. The alternative to separation then becomes continued dissention, which is detrimental to the individuals and often the enterprise.\(^11\) The optimum solution is a negotiated buy-out of one partner by the other in which the buy-out price reflects the willing-

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\(^{4}\) Under the Internal Revenue Code, partnerships do not pay tax upon their income. Instead, the partners each report as part of their own taxable income their share of the firm's profits. I.R.C. §§ 701-02 (West 1988). Corporations, however, are separate taxing entities. Id. § 11. Shareholders pay an additional tax upon their receipt of dividends. Id. § 61(a). For many years, lower tax rates for corporations offset this so-called double taxation of corporate income, at least insofar as the company retained a substantial percentage of its earnings. After 1986, however, individual rates are generally lower than corporate rates. Id. §§ 1, 11. See generally Freeman, Some Early Strategies for the Methodical Disincorporation of America After the Tax Reform Act of 1986: Grafting Partnerships Onto C Corporations, Running Amok with the Master Limited Partnership Concept, and Generally Endeavoring to Defeat the Intention of the Draftsmen of the Repeal of General Utilities, 64 Taxes 962 (1986).

\(^{5}\) A Westlaw search of "partnership w/p freeze-out or squeeze-out" yields ten reported opinions in which partners alleged they were the victims of such a tactic. Numerous other cases involving partnership freeze-outs do not use the term. See infra notes 38, 39 & 53.

\(^{6}\) See F. O'Neal & J. Derwin, supra note 2, at § 8.11.

\(^{7}\) See infra notes 67-76, 90-97, 102-05, 153-89 & 237-40 and accompanying text.

\(^{8}\) See infra notes 49-53 and accompanying text and infra note 237.

\(^{9}\) See infra notes 67-82, 90-146, 153-82 & 244-46 and accompanying text.

\(^{10}\) Cf. Yanow v. Teal Indus., Inc., 178 Conn. 263, 422 A.2d 311, 317 n.6 (1979) (defining corporate freeze-outs).

\(^{11}\) See Brudney & Chirelstein, supra note 1, at 1356-57 n.9.
ness of one individual to pay more for the business than the other thinks it is worth to him. The term "freeze-out" should not describe the situation in which a partner is unable to reach a settlement and thereupon uses some tactic to achieve an equivalent result. Hence, as used in this article, a freeze-out refers to a partner's ending his association with another partner while the business continues under circumstances in which neither the willingness to pay a greater price nor the other partner's concurrence determines the privilege to keep the enterprise. In this situation, an unfairness exists in both the ability of the parties to compete for the venture, and also in the consideration the departing partner receives for his interest.

Freeze-outs occur in partnerships whose planning consists of little more than a handshake, as well as those founded upon an elaborate written agreement. In the former type of partnership, various provisions of the Uniform Partnership Act ("UPA"), which the courts have interpreted, expanded, and sometimes ignored, fill the gaps of the parties' planning and govern their relationship. One consequence is that if the parties have not set a term for their partnership or otherwise defined the after-effects of dissolution, all partners have the right to dissolve the relationship at any time and demand liquidation. This ability to dissolve at will both precludes some types of freeze-outs and creates the potential for others. Thus, part II of this article will explore how freeze-outs can occur in the partnership at will and what the courts might do in response. Part III considers freeze-outs in the firm whose members have engaged in some planning. Many provisions of the UPA expressly allow partnership agreements to supplant the authority of those provisions. Many who write about partnerships have a corresponding tendency to view most problems as reflecting a failure of planning. To some extent this view is tautological. Nevertheless, the problem of freeze-outs illustrates how partnership agreements can sometimes make things worse rather than better. Thus, it

12. In theory, the partner who possesses the most confidence in his ability to generate profits from the enterprise should be the one willing to pay the most for it. Thus, such a negotiated purchase optimizes economic efficiency.

For convenience, the text will often speak about the paradigm partnership of two members, one who freezes out the other. Naturally, however, situations often could involve a group of partners who freeze out another group. The analysis generally remains the same.

15. UNIF. PARTNERSHIP ACT, 6 U.L.A. 1 (West 1969 & Supp. 1988). Since its promulgation in 1914, every state except Louisiana has enacted the UPA.
16. See infra notes 40-42 and accompanying text.
is important to explore both the types of agreements that are effective in combating the problem and how the courts might respond when individuals agree to terms that increase the danger of freeze-outs.

II. Freez-Outs in the Partnership at Will

A. Nature of the Problem

Freeze-outs in partnerships require different techniques than those employed in corporate settings. Corporate freeze-outs typically fall into two broad types, one that the members of public corporations favor and the other that the members of closely held companies favor. In public corporations (although occasionally used in closely held concerns) the principal approach involves the employment of reorganization provisions of the corporation codes. For example, majority shareholders may merge the corporation into another company (the parent or a newly created shell) with minority shareholders receiving cash or debt instead of stock in the surviving entity. In closely held companies, the common technique involves what many refer to as a squeeze-out. Specifically, majority shareholders use their voting control to exclude the minority from participation on the board of directors. Then, acting as directors, the majority removes the minority from any employment with the company and declares little or no dividends. This action does not actually freeze out the minority shareholders, but it does freeze them into a worthless investment. The majority often follows up, however, with a proposal to buy out the minority at a low price.


20. See, e.g., Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Roland Int’l Corp. v. Najjar, 407 A.2d 1052 (Del. 1979); Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977). See generally Brudney & Chirelstein, supra note 1, at 1357. Other reorganization freeze-out techniques include: (i) dissolving the company under a plan in which the productive assets go to the majority shareholders (or an entity they control) while the minority receives cash (e.g., Kellog v. Georgia-Pacific Paper Co., 227 F. Supp. 719 (W.D. Ark. 1964)); (ii) selling all the corporation’s assets for cash to a new company, which the majority owns (e.g., Cathedral Estates, Inc. v. Taft Realty Corp., 157 F. Supp. 896 (D. Conn. 1954), aff’d, 251 F.2d 340 (2d Cir. 1957)); and (iii) reverse stock splits (e.g., Teschner v. Chicago Title & Trust Co., 59 Ill. 2d 452, 322 N.E.2d 54 (1974)).


Partnerships dissoluble at will are not particularly receptive to either of these tactics. The UPA contains no parallels to merger, or to any other reorganization provisions found in corporation codes, which allow majority shareholders to force out minority interests. Instead, three methods exist to merge a partnership business into another entity: (1) All the partners can assign their interest to the entity; (2) the partnership can dissolve and distribute its assets to the partners, who then sell them to the entity; or (3) the partnership can sell all its assets to the entity. All three methods require unanimous consent. A majority of partners lack the statutory power to require the minority to assign their interests in the firm. Also, any partner has the right to demand distribution in cash rather than in kind, thereby precluding the second approach over the objection of any partner. Finally, the UPA forbids less than all the partners from selling the firm's goodwill or doing any other act that would make it impossible for the partnership to carry on its business. Thus, the UPA effectively precludes the sale of all the firm's assets over the objection of any partner.

Similarly, squeeze-outs cannot occur in partnerships with the same nominal legality they enjoy in corporations. Barring contrary agreement, all partners have equal rights to participate in management. The UPA also grants all partners the right to inspect firm books and records and to demand information. The UPA is less explicit concerning distributions to partners. It states that partners share profits equally in the absence of other agreement, but this does not resolve how much profit they can withdraw from the firm. The act contains no parallel to the corporation rule that directors have discretion over the declaration of dividends. Nevertheless, a majority of partners might argue that under section 18(h) of the UPA they can dictate the amount of withdrawals.
minority, however, might argue that limiting withdrawal of profits—which has the effect of increasing capital contributions—contravenes the partnership contract since the contract expressly or impliedly sets contributions. This argument would place it beyond the power of the majority.35 Equally important, the UPA precludes salaries to partners unless all partners agree to the payment.36 Hence, the majority is unable to bring about a squeeze-out in which it continues to receive income through salaries while the minority does not.37 Finally, if all else fails, minority partners possess an escape valve against a squeeze-out, i.e., their ability to dissolve the partnership at will.

How then do freeze-outs occur in partnerships at will? Given the lack of nominally legal methods, partners often resort to cruder tactics involving blatant illegality or force. One tactic that partners use is to misappropriate the partnership's tangible assets and to transfer them to a new business entity (be it a proprietorship, partnership, or corporation) that excludes the undesired partner.38 Alternately, partners often physically exclude other partners from the firm's premises or from participating in management.39 The legal issues that these actions raise are not overly complex. A second tactic raises far greater difficulty. This approach involves dissolving the partnership with the intent of capturing the business in the ensuing liquidation. Section 31 of the UPA provides that if a partnership is not for a term, each partner may properly dissolve at will.40 Section 38(1) then grants each partner the right to demand that the partnership apply the firm's assets to discharge its debts and to distribute the surplus to the partners “in cash.”41 This means that the dissolving part-

35. See id. (acts in contravention of partnership agreement require unanimous consent).
36. Id. § 18(f).
37. If the partnership contract provides for salaries, the majority still cannot alter them up or down (unless the agreement specifically gives the majority this power). See, e.g., Quillen v. Titus, 172 Va. 523, 2 S.E.2d 284 (1939).
40. UPA § 31 (West 1969 & Supp. 1988) states in pertinent part: “Dissolution is caused: 
(i) Without violation of the agreement between the partners, . . . (b) By the express will of any partner when no definite term or particular undertaking is specified . . . .”
41. UPA § 38(1) (West 1969 & Supp. 1988) reads in pertinent part:
When dissolution is caused in any way, except in contravention of the partnership agreement, each partner, as against his co-partners and all persons claiming through them in respect of their interests in the partnership, unless otherwise
ner can force the firm to sell its assets unless all the partners agree otherwise. The dissolving partner could then purchase the assets and continue the business to the exclusion of his or her former partner. Yet, nothing unfair exists in this fact alone, nor is it a freeze-out in the sense defined above. Competitive bidding for the firm's assets presumably gives each partner the opportunity to be the individual who continues the business. Moreover, the bidding between the partners normally should assure a fair price since each has the power to prevent a purchaser from buying the business for less than he thinks it is worth. Thus, a freeze-out can only occur through dissolution and liquidation if some factor prevents full competition between the partners in bidding for the business. A review of the cases suggests two situations in which this can occur.

The first situation involves the well-healed versus strapped partner scenario. Simply, this situation is one in which the partner causing dissolution possesses the funds to buy the business, but the other partner does not. The case of Page v. Page provides an illustration and something of a variation on this theme. The Pages were partners in a linen supply business in Santa Maria, California. Plaintiff sued to establish his right to dissolve the firm at will. Defendant responded by unsuccessfully claiming

agreed, may have the partnership property applied to discharge its liabilities, and the surplus applied to pay in cash the net amount owing to the respective partners.


44. Several disadvantages face the partner seeking to continue the business by acquiring its assets in a liquidation sale. Initially, he must come up with the funds to buy the assets. He also risks losing the assets to an outsider willing to pay more. Further, favorable agreements that the firm entered into, such as leases, licenses, or franchises, may not be assignable, but rather terminable upon dissolution. UPA REVISION SUBCOMMITTEE OF THE PARTNERSHIP COMMITTEE OF THE ABA CORPORATION, BANKING AND BUSINESS LAW SECTION, SHOULD THE UNIFORM PARTNERSHIP ACT BE REVISIED? 103 (1986) [hereinafter UPA REVISION]. Finally, a liquidation sale may entail unfavorable tax consequences. If the assets have appreciated, the purchasing partner presumably must recognize his distributive share of the firm's gain on their sale even though he was the buyer. See I.R.C. § 707(a)(1) (West 1988); Bromberg, Partnership Dissolution—Causes, Consequences and Cures, 43 Tex. L. Rev. 631, 659-66 (1965). But see Rev. Rul. 66-264, 1966-2 C.B. 248. Purchase of the other partner's interest in the firm, however, entails no such recognition and, if properly structured, could yield a write-off. See I.R.C. § 736 (West 1988); Foxman v. Commissioner, 41 T.C. 535 (1964). These factors typically lead partners to reach a negotiated buy-out rather than go through a liquidation sale. They also give the departing partner a better negotiating position.

45. 55 Cal. 2d 192, 359 P.2d 41, 10 Cal. Rptr. 645 (1961).
that the parties had agreed to a partnership for a term. In addition, he charged that plaintiff intended to freeze him out of a business that had recently become profitable due to the establishment of Vandenberg Air Force Base nearby. Specifically, he asserted that plaintiff had a superior financial position to obtain the business on liquidation since the partnership owed a substantial sum of money to a company that plaintiff owned, whereas a period of losses by the business had exhausted most of the defendant's capital investment. While not explicitly stated, the underlying thrust of these allegations appears to be that defendant lacked the funds to compete with plaintiff, who could credit bid against the debt the partnership owed his company.

The second situation involves the unaccounted for intangibles problem. Here, the partner causing dissolution is able to appropriate some intangible values of the partnership's business (elements that often go under the rubric of goodwill) without having to purchase them on liquidation. The tangible assets that the firm then sells may only represent a skeleton of the business. The purchase of these assets would not allow the other partner effectively to continue the enterprise nor will their sale to the partner causing dissolution produce anything like the fair market value of the business as a going concern. A vivid example of this type of freeze-out is found in Cude v. Couch. Cude and Couch were partners operating a laundromat on premises that they rented on a month-to-month basis from Couch. Couch dissolved the firm and announced he would no longer rent the premises to anyone else. Couch then purchased the partnership's equipment at auction for a fraction of the price he and Cude originally spent to buy the laundromat as a going concern. He continued to operate the business with his son.

46. 55 Cal. 2d at 196, 359 P.2d at 44, 10 Cal. Rptr. at 646.
47. Id.
48. Prentiss v. Sheffel, 20 Ariz. App. 410, 513 P.2d 949 (1973) (provides a second illustration of a well-healed versus strapped partner claim; the defendant asserted that the plaintiffs had an unfair advantage in bidding for the partnership's property since they could credit bid against their 85% interest in the firm). See also Davis v. Davis, 149 Colo. 1, 366 P.2d 857 (1961) (husband, in husband and wife partnership, was unable to obtain financing to buy partnership's assets after dissolution while his wife could).
49. 588 S.W.2d 554 (Tenn. 1979).
50. Id. at 555.
51. Id.
52. Id.
53. Id. Numerous other examples exist of this phenomenon. See, e.g., Fulton v. Baxter, 596 P.2d 540 (Okla. 1979) (defendant appropriated insurance agency contracts, lease, and telephone listing following dissolution); Lavin v. Ehrlich, 80 Misc. 2d 247, 363 N.Y.S.2d 50 (1974) (after dissolution, defendant purchased building that the partnership had rented to conduct storefront tax preparation business); Smith v. Bull, 50 Cal. 294, 325 P.2d 463 (1958) (defendants took advertising agency's primary client and employees following dissolution);
B. Solutions

Dealing with Crude Expulsion and Misappropriation

The basic remedy for this type of freeze-out is dissolution. It could occur simply by the express will of the victimized partner.\textsuperscript{54} Alternately, this partner could sue for a judicial decree of dissolution under section 32 of the UPA.\textsuperscript{55} The critical question is what happens next. Three outcomes are possible.

The most intriguing possibility is for the victimized partner to claim that the expulsion or misappropriation constitutes a wrongful dissolution within the meaning of section 38(2) of the UPA. Section 38(2) applies in the event of dissolution "in contravention of the partnership agreement."\textsuperscript{56} It denies the partner who wrongfully causes dissolution, the op-

\begin{footnotesize}
\begin{enumerate}
\item Salter v. Condon, 236 Ill. App. 17 (1925) (defendant owned land on which the partnership operated a golf course). At times, the capturing of key intangible values of the business, such as location, clients, and employee organization, coincides with the misappropriation of tangible assets. See, e.g., Swann v. Mitchell, 435 So. 2d 797 (Fla. 1983); Stone City Attractions, Inc. v. Henderson, 571 S.W.2d 206 (Tex. Civ. App. 1978). Appropriation of intangibles, however, raises two added complexities. First, there is the question of whether they constitute partnership property. See infra notes 237-41 and accompanying text. Also, one partner often has or obtains a legitimate hold on these items (for example, by owning the location as in \textit{Cude}) that prevents their sale even if one could say that a partnership asset was involved.
\item UPA § 31(1)(b) (West 1969 & Supp. 1988).
\item Id. § 32(1)(c) & (d) allows a court to dissolve a partnership when a partner has been guilty of such conduct as tends to affect prejudicially the carrying on of the business, . . . persistently commits a breach of the partnership agreement, or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable to carry on the business in partnership with him . . . .
\end{enumerate}
\end{footnotesize}
tion to demand liquidation pursuant to section 38(1). Instead, the other partner or partners may continue the business without the necessity of bidding for its assets in a liquidation sale. To do so, they either may pay immediately to the wrongfully acting partner the appraised value of his interest—but without taking into account the worth of the business’ goodwill and subtracting any damages—or else post a bond to protect his interest until the agreed term for the partnership lapses. In either event, the continuing partner or partners must indemnify the wrongdoer against present and future firm liabilities.

A certain elegant irony exists in this solution since it turns the tables completely on the partner who attempts to take over the business by force or fraud. In addition, some authority supports this outcome. Several decisions involving individuals wrongfully expelled from partnerships for a term held that such conduct not only constitutes grounds for dissolution under section 32, but also entitles the expelled partner to continue the business pursuant to section 38(2). While this result in a partnership for a term seems almost self-evident, it does require some expansion of the language of the UPA. A dissolution “caused in contravention of the partnership agreement” triggers section 38(2). Section 31(2) defines a dissolution caused in contravention as one brought on by the express will of any partner “where the circumstances do not permit a dissolution under any other provision of this section.”

This appears, however, to be simply demnify him against all present or future partnership liabilities.

c A partner who has caused the dissolution wrongfully shall have: 

II. If the business is continued under paragraph (2b) of this section the right as against his co-partners and all claiming through them in respect of their interests in the partnership, to have the value of his interest in the partnership, less any damages caused to his co-partners by the dissolution, ascertained and paid to him in cash, or the payment secured by bond approved by the court, and to be released from all existing liabilities of the partnership; but in ascertaining the value of the partner’s interest the value of the good-will of the business shall not be considered.

57. Id.
58. Id.
59. Id.
60. Id.
61. Vangel v. Vangel, 116 Cal. App. 2d 615, 254 P.2d 919 (1953); Dow v. Beals, 149 Misc. 631, 268 N.Y.S.425 (1933). See also Zeibak v. Nasser, 12 Cal. 2d 1, 82 P.2d 375 (1938) (Section 38(2) applied when judicial dissolution ordered because of wrongful conduct by one partner); Drashner v. Sorenson, 75 S.D. 247, 63 N.W.2d 255 (1954) (same application of section 38(2)).
63. Id. § 31(2).
64. See id. § 31(6) (cross-references dissolution by decree of court under section 32 and
an inadvertent drafting error in the UPA.\textsuperscript{65}

The far more difficult question is whether the same result can follow when the partnership is at will. A line of pre-UPA Texas court decisions held that forcible expulsion, even from a partnership at will, entitled the expelled partner to damages—including punitive damages—going far beyond the normal right to an accounting following any dissolution.\textsuperscript{66} Recently, the Illinois Appellate Court took the final step. In \textit{Monteleone v. Monteleone}\textsuperscript{67} three partners operated an auto body shop.\textsuperscript{68} One partner sued to dissolve, claiming the others had wrongfully excluded him from the partnership premises.\textsuperscript{69} The other two partners counterclaimed, contending that plaintiff's wrongful conduct caused the dissolution.\textsuperscript{70} The trial court ignored the question of who was at fault and simply ordered the partnership to sell its assets.\textsuperscript{71} The appellate court reversed and instructed the lower court to grant defendants the right to continue the business under section 38(2) if it found plaintiff at fault.\textsuperscript{72} In reaching this conclusion, the court rejected the contention that section 38(2) could not apply since all of the parties conceded this was a partnership at will.\textsuperscript{73}

Substantial reasons exist to question the holding in \textit{Monteleone}. First, a number of courts have stated that there cannot be a wrongful dissolu-

\textsuperscript{65}. See A. Bromberg, \textit{supra} note 18, at 430.

\textsuperscript{66}. See Ball v. Britton, 58 Tex. 57 (1882); Howell v. Bowden, 368 S.W.2d 842 (Tex. Civ. App. 1963); Sewell v. Connor, 23 S.W. 555 (Tex. Civ. App. 1893). For example, in \textit{Ball}, the court explained that while defendant had the right to withdraw from the firm at will, he did not have the right to expel plaintiff from it and retain all the assets. \textit{Ball}, 58 Tex. at 62. More significantly, the court went beyond requiring defendant to account for plaintiff's share of the partnership's property and any profits made therefrom. \textit{Compare UPA} § 42 (West 1969 & Supp. 1988). Instead, the court awarded to plaintiff damages measured by the value of his services to the firm as well as exemplary damages. \textit{Ball}, 58 Tex. at 65.

\textsuperscript{67}. 147 Ill. App. 3d 265, 497 N.E.2d 1221 (1986).

\textsuperscript{68}. 497 N.E.2d at 1223.

\textsuperscript{69}. \textit{Id}.

\textsuperscript{70}. \textit{Id}. Specifically, the other two partners claimed he misappropriated partnership funds, failed to contribute to the operation of the business, refused to return firm books and records, and wrongfully demanded that they make his son a partner and discharge a certain employee. \textit{Id}.

\textsuperscript{71}. \textit{Id}.

\textsuperscript{72}. \textit{Id}. at 1224. While not stated, presumably section 38(2) would have entitled plaintiff to continue the business if the trial court found that he was innocent of wrongdoing and his brothers wrongfully excluded him from the business. Plaintiff, however, did not request this relief.

\textsuperscript{73}. \textit{Id}. at 1225. \textit{See also} Prentiss v. Sheffel, 20 Ariz. App. 411, 513 P.2d 949 (1973) (court suggests that UPA § 38(2)(a)(II) might entitle a partner expelled from participation in the management of a partnership at will to recover damages).
tion of a partnership at will. For example, in Johnson v. Kennedy, the Massachusetts Supreme Court reached a holding opposite the Illinois decision. In Johnson, the trial court found that defendant had wrongfully dissolved an insurance agency by secretly stealing all of its assets. The supreme court reversed, simply explaining that “because the firm was a partnership at will, Kennedy’s termination of it, however unseemly in manner and method, was not a legal wrong.” Moreover, the language of section 31 of the UPA might make it difficult to call the dissolution of a partnership at will wrongful, at least within the meaning of section 38(2). Section 31(1)(b) indicates that dissolution by the express will of any partner is not in violation of the agreement if no term is set. On the other hand, forcible expulsion or misappropriation goes beyond simply expressing a will to dissolve. A more practical problem exists in the fact that section 38(2) refers to the right of the innocent partners to continue the business for the “agreed term.” If the partnership is at will, what is the agreed term? Monteleone brushed aside this question by stating that the agreed term remained at the will of the innocent partners. The result seems reasonable if the innocent partners immediately pay off the partner in the wrong. If, however, they exercise their option to post a bond for the remaining term, the result is disproportionally harsh in comparison with the initial offense.

74. See, e.g., Evans v. Gunnip, 125 A.2d 378 (Del. 1956); Young v. Cooper, 203 S.W.2d 376 (Tenn. App. 1947).
76. 214 N.E.2d at 277.
77. Id. at 278.
78. See supra note 40.
79. See Ball v. Britton, 58 Tex. 57 (1882).
80. See supra note 65.
81. Monteleone, 497 N.E.2d at 1225.
82. Cf. Dow v. Beals, 149 Misc. 631, 268 N.Y.S. 425 (1933) (refusing to allow plaintiff to post an undertaking in lieu of paying cash for defendants’ interest despite granting plaintiff relief under UPA § 38(2) based upon his expulsion from the firm). It should be noted that such an indefinite delay in payment will occur if a partner wrongfully leaves a partnership whose term is until such time as the partners agree to dissolve. In this event, however, the partners specifically agreed to an open-ended term for the venture with its concomitant disability on their withdrawing their capital for an indefinite period of time. Monteleone also raises the possibility that the wrongful conduct of the expelled partner may justify the expulsion. The notion of a justifiable freeze-out from a partnership at will presents several difficulties. First, the UPA indicates that expulsion does not contravene the partnership contract when it is “in accordance with such a power conferred by the agreement.” UPA § 31(1)(d) (West 1969 & Supp. 1988). The negative implication is that expulsion from a firm whose agreement does not confer this power contravenes the contract. See Hillman, Misconduct as a Basis for Excluding or Expelling a Partner: Effecting Commercial Divorce and Securing Custody of the Business, 78 Nw. U.L. Rev. 527, 539 (1983). Moreover, section 32 provides partners the ability to seek a judicial decree of dissolution in the
A second alternative following dissolution is for the victimized partner to concede the business and simply demand payment for the appraised value of his interest as well as compensation for the delay in payment. Section 42 of the UPA provides this option. This section indicates that when a partner retires and other partners continue the business without settling accounts, the departing partner is entitled to receive the value of his interest as of the date of dissolution plus his choice of interest or profits accrued from leaving this sum in the business. To the extent a wrongfully expelled partner wishes this remedy, there is little question it

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event of wrongful conduct. See supra note 55. This section suggests the UPA contemplates a judicial determination of wrongful conduct rather than self-help, at least without an expulsion provision in the partnership contract.

Assuming courts nevertheless accept this approach, they face a spectrum of possible outcomes. Monteleone provides a good illustration. The plaintiff's conduct there could have been sufficiently egregious both to justify the defendants' self-help remedy of expelling him and to allow them to continue the business under section 38(2). At least one court, however, has indicated in the context of a partnership for a term that some conduct might be sufficiently wrongful to allow dissolution under section 32 (and continuation of the business under section 38(2)), but not so bad as to allow self-help expulsion. Vangel v. Vangel, 116 Cal. App. 2d 615, 626, 254 P.2d 919, 926 (1953). See generally, Hillman, supra at 541. If the plaintiff's actions came within these parameters, then the defendants acted wrongfully themselves in expelling him. If both sides were in the wrong, presumably neither can continue the business under section 38(2). Stark v. Reingold, 18 N.J. 251, 113 A.2d 679, 683, 685 (1955). Also, if the plaintiff acted wrongfully, he still does not forfeit his interest in the partnership. See, e.g., Dobson v. Dobson, 594 S.W.2d 177 (Tex. Civ. App. 1980); B.K.K. Co. v. Schultz, 7 Cal. App. 3d 786, 86 Cal. Rptr. 780 (1970). Hence, even if the defendants could legitimately expel the plaintiff, their failure to account for his interest (thereby forcing him to sue) may itself have been wrongful conduct. Alternately, the plaintiff's conduct may have been wrongful, but not sufficient to either justify his expulsion or the defendants' continuing the business under section 38(2). See, e.g., Engel v. Vernon, 215 N.W.2d 506 (Iowa 1974) (violation of partnership agreement did not harm other partner); Lyon v. Lyon, 246 Cal. App. 2d 519, 54 Cal. Rptr. 829 (1966) (attempting to misappropriate $10,000 did not justify dissolution); Potter v. Brown, 328 Pa. 762, 54 Cal. Rptr. 829 (1938). Presumably, the plaintiff then becomes the aggrieved partner entitled to invoke section 38(2). Finally, the plaintiff's conduct might not have been wrongful at all. Of course, courts can remove the need to resolve all these possibilities (and the concomitant risks they impose upon actions undertaken by partners) by refusing to find section 38(2) applicable to partnerships at will.

83. UPA § 42 (West 1969 & Supp. 1988) provides in pertinent part:

When any partner retires or dies, and the business is continued under any of the conditions set forth in section 41(1, 2, 3, 5, 6), or section 38(2b) without any settlement of accounts as between him or his estate and the person or partnership continuing the business, unless otherwise agreed, he or his legal representative as against such persons or partnership may have the value of his interest at the date of dissolution ascertained, and shall receive as an ordinary creditor an amount equal to the value of his interest in the dissolved partnership with interest, or, at his option or at the option of his legal representative, in lieu of interest, the profits attributable to the use of his right in the property of the dissolved partnership.

...
should apply. The partner misappropriating the business can hardly complain about paying the other partner for his interest. While section 42 may put the departing partner in something of a no-lose situation, this is not too harsh a penalty on the partner who boots another out of the firm.

Finally, if the victimized partner is not satisfied with receiving the appraised value of his interest, he has the option to demand liquidation. This result is clear under the statute. Section 42 applies only if the departing partner consents to allow the other partner or partners to continue the business. If he does not consent, the liquidation right contained in section 38(1) remains available. Even if the result were not clear under the statute, elementary policy considerations compel the same conclusion. If courts relegate the wrongfully expelled partner exclusively to receiving payment for the appraised value of his interest, this rewards the partner for kicking the other out by guaranteeing that he will be the one to continue the enterprise. This alternative could only encourage an

84. See, e.g., Pignataro v. Russo, 633 S.W.2d 571 (Tex. Civ. App. 1982); Stone City Attractions v. Henderson, 571 S.W.2d 206 (Tex. Civ. App. 1978). But see Blut v. Katz, 13 N.J. 374, 99 A.2d 785 (1953). In Blut, the court refused to allow the estate of a deceased partner to obtain profits pursuant to section 42 when the estate did not explicitly consent to the surviving partners continuing the business (albeit the estate did not obtain liquidation). The court correctly notes that the language of section 42, by its cross-reference to section 41, applies when the business continues with the consent of the departing partner. It displays, however, a cramped interpretation of "consent." The departing partner seemingly exercises consent to continue the business when he does not demand liquidation (this being the statutory alternative to section 42's buy-out). Indeed, the trial court in Blut awarded the estate the value of its interest without selling the partnership's assets, 99 A.2d at 789, something only provided for under section 42 and improper had the estate demanded liquidation. See supra notes 40 & 41 and accompanying text.

85. If the business does well, the departing partner can demand a share of the profits that the partnership made before the settling of accounts. If the firm's assets significantly appreciate, the departing partner might forego his section 42 remedy and demand liquidation. See supra notes 41 & 42 and accompanying text. On the other hand, if the business does poorly prior to the settling of accounts, the departing partner is entitled to demand fixed interest for the use of his capital. Moreover, a decline in the value of the firm's assets will not affect him, since section 42 specifies valuation as of the date of dissolution. See generally M & C Creditors Corp. v. Pratt, 172 Misc. 695, 17 N.Y.S.2d 240 (1938) (explaining that section 42 is designed to put the risk of loss on the continuing partner).

86. Blut v. Katz, 13 N.J. 374, 99 A.2d 785 (1953). Commentators have criticized Blut for its refusal to allow the estate of a deceased partner to collect profits under section 42 when the estate evidently did not specifically consent to the continuation of the business (albeit the firm was not liquidated). Note, Profit Rights and Creditors' Priorities After a Partner's Death or Retirement: Section 42 of the UPA, 63 Yale L.J. 709 (1954). Whether the section chokes off a departing partner's right to demand liquidation, however, presents a very different question.

87. See supra notes 40 & 41 and accompanying text.
unfortunate degree of reliance on self-help and force.

Dealing with Dissolution and Liquidation Freeze-Outs

Freeze-outs through dissolution and liquidation pose a much less tractable problem than the crude techniques considered above. Indeed, a pair of writers some years ago stated that the technique in many instances proves to be unimpeachable. This view is too pessimistic. Authority exists for five different approaches to the problem. The following text explores their strengths and weaknesses.

Judicial Scrutiny for Bad Faith Dissolution. One approach to deal with freeze-outs through dissolution and liquidation is to assert that such a plan breaches a partner’s fiduciary duty. It is well established that partners’ fiduciary duties to each other extend through liquidation. In now famous dictum, the California Supreme Court in Page v. Page warned that dissolving a partnership in bad faith to freeze out a partner at an unfair price violates this duty and constitutes a wrongful dissolution. Whether this approach provides a viable solution to the problem depends upon the answers to several questions.

First, what support exists for the court’s assertion that a partner’s motive qualifies his right to dissolve a partnership at will? The court, in its dictum, enters the fray affecting many areas of law regarding whether conduct otherwise unassailable creates liability when undertaken with bad motives. While Page does not cite them, earlier cases involving partnerships at will already had divided over this question. For example,

88. F. O’Neal & J. Derwin, supra note 2, at § 6.04.
90. 55 Cal. 2d 192, 359 P.2d 41, 10 Cal. Rptr. 643 (1961).
91. 359 P.2d at 44, 10 Cal. Rptr. at 646.
92. Compare Gans v. Delaware Terminal Corp., 23 Del. Ch. 69, 2 A.2d 154 (1938) (holding that if an act is otherwise lawful, no one can claim to be damaged by it due to the fact that either bad faith or malicious purpose inspired it), with Tuttle v. Buck, 107 Minn. 145, 119 N.W. 946 (1909) (contrary holding). One of the situations in which courts have divided on this issue is dealing with spite fences (i.e., obstructions to a neighbor’s light and air motivated solely by malice). Compare Musumeci v. Leonardo, 77 R.I. 255, 75 A.2d 175 (1950) (holding that no cause of action in nuisance exists simply because an otherwise lawful construction was done for a malicious purpose), with Sundowner, Inc. v. King, 55 Idaho 367, 509 P.2d 785 (1973) (contrary holding). See generally Comment, Obstruction of Sunlight as a Private Nuisance, 65 Calif. L. Rev. 94, 99-102 (1977). Of more direct relevance, a similar division exists when dealing with corporate freeze-outs. Compare Rossing v. State Bank, 181 Iowa 1013, 165 N.W. 254 (1917) (dissolution held not unlawful because of a motive to freeze out minority shareholders), with Lebold v. Inland Steel Co., 125 F.2d 369 (7th Cir. 1941), cert. denied, 316 U.S. 675 (1941) (contrary authority).
over a century before Page, the Supreme Court of Arkansas in Howell v. Harvey faced a situation in which a partner dissolved a partnership to appropriate for himself profits that the firm could have made in a rising market for its goods. The court held that a partner lacks the right to dissolve in bad faith even a partnership at will. On the other hand, in Salter v. Condon, the Illinois Appellate Court rejected Howell and held that a partner’s intent did not determine his right to terminate such a partnership.

Adoption of the UPA failed to resolve this division. Section 31(1)(b) states that a partner can dissolve the firm without violating the partnership agreement when the agreement specifies no term. But this section does not expressly rule out any good faith limit upon a decision to dissolve. Page cited section 21 in support of its dictum. Section 21, however, says nothing about a good faith limitation on dissolution. It simply requires a partner to account for any profits made in connection with the formation, conduct, or liquidation of the partnership. While this section provides the statutory foundation for partners’ fiduciary duties, it

93. 5 Ark. 270 (1843).
94. Id. at 270.
95. Id. at 280-81. See also Trigg v. Shelton, 249 S.W. 209 (Tex. Civ. App. 1923) (dictum). Howell seemingly illustrates effective use of the good faith approach to prevent a freeze-out. Yet, given the fact that the defendant appropriated a partnership opportunity, it was unnecessary to explore the motives for the dissolution. Even if the firm dissolved for entirely innocent causes (such as death or the expiration of its term), the defendant breached his duty in taking the opportunity. See, e.g., Meinhard v. Salmon, 249 N.Y. 158, 164 N.E. 545 (1928).
96. 236 Ill. App. 17 (1925).
97. Id. at 25-26. The situation in Salter was remarkably similar to that in Cude v. Couch, 588 S.W.2d 554 (Tenn. 1979), discussed in text accompanying supra notes 49-53. Condon entered into a partnership with Salter to develop land that Condon owned into a golf course. After Salter completed the course and built up the business, Condon dissolved the partnership and continued to operate the golf course on his own. The court’s statement about bad faith was dictum, however, since it found no evidence of a fraudulent design. (It is difficult to understand why Condon’s conduct could not allow this inference.) For other cases suggesting that good faith does not limit dissolution of a partnership at will, see, e.g., Evans v. Gunnip, 125 A.2d 378 (Del. Ch. 1956), modified, 135 A.2d 128 (Del. 1957); Young v. Cooper, 303 S.W.2d 376 (Tenn. App. 1947); Freund v. Murray, 39 Mont. 539, 104 P. 683 (1909).
98. 55 Cal. 2d at 197, 359 P.2d at 44, 10 Cal. Rptr. at 646.
99. 55 Cal. 2d at 197, 359 P.2d at 44, 10 Cal. Rptr. at 646.
100. UPA § 21 (West 1969 & Supp. 1988) reads in pertinent part:

(1) Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

does not indicate that those duties require a good faith motive to dissolve a partnership at will.

Since Page, there has been uncertain adherence to its dictum by other courts. California courts, of course, follow Page.\(^{102}\) Illinois also may have backed off Salter.\(^{103}\) Decisions in other jurisdictions, however, have either equivocated\(^{104}\) or rejected any limits on the right to dissolve a partnership at will.\(^{105}\)

Having ignored the partnership cases, Page turned for support to cases involving corporate freeze-outs.\(^{106}\) A number of courts have held that majority shareholders breached their fiduciary duty to the minority by merging\(^{107}\) or dissolving\(^{108}\) a corporation in order to freeze out the minority

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103. In Mandell v. Centrum Frontier Corp., 86 Ill. App. 3d 437, 407 N.E.2d 821 (1980), an Illinois Appellate Court faced the contention that the dissolution of a limited partnership and subsequent sale of its assets to the limited partners constituted a freeze-out. Rather than reject the claim out of hand (and without citing Salter), the court indicated that plaintiff’s purchase of the assets did not show that the dissolution and sale “were merely a device to exclude defendants from the business.” 407 N.E.2d at 832. The court thus hinted at a willingness to attack dissolutions that were merely such a device. It should be noted, however, that Mandell did not involve a partnership at will.
104. In Nicholes v. Hunt, 273 Or. 255, 541 P.2d 820 (1975), the Oregon Supreme Court replied to an argument that defendant dissolved in bad faith by saying, “assuming that there was such a duty of good faith in this case, the evidence proves that defendant acted in good faith and did not act in contravention of the oral partnership at will.” 541 P.2d at 824 (emphasis added). In Cude v. Couch, 588 S.W.2d 554 (Tenn. 1979), Cude charged that his partner, Couch, breached his fiduciary duty by secretly buying the firm’s assets in a liquidation sale after depressing their value by refusing to lease the firm’s premises. At one point in its opinion, the majority of the court stated that no evidence existed to show that Couch used his advantage of owning the firm’s premises to force out Cude, thereby suggesting a willingness to consider a bad faith freeze-out claim. Id. at 556. Nevertheless, for the most part, both majority and dissenting opinions focused upon the question of whether any breach of fiduciary duty occurred in carrying out the liquidation rather than in Couch’s decision to dissolve. In Prentiss v. Sheffel, 20 Ariz. App. 411, 513 P.2d 949 (1973), the court’s opinion refers to a lack of evidence that plaintiffs excluded defendant from management in bad faith rather than because of the inability of the partners to get along. The court subsequently in the opinion distinguished cases that defendant cited, as involving bad faith or other wrongful conduct. Yet, it is unclear whether the court meant by these references to suggest that the simple decision to dissolve (in contrast to freezing a partner out of management before dissolving the firm) is subject to a good faith limit.
106. 55 Cal. 2d at 197, 399 P.2d at 44, 10 Cal. Rptr. at 646.
shareholders. At first glance, these cases seem to provide solid support for the Page dictum. This support is especially evident given the traditionally greater fiduciary duty owed between partners compared to the duty existing between shareholders. On further reflection, however, the analogy shows weaknesses. Typically, corporate freeze-outs involve director as well as shareholder action. Indeed, merger provisions of corporation codes require the board to initiate the transaction. Directors owe a duty to all shareholders, a duty not completely analogous to whatever obligation partners have to temper the exercise of their personal rights with good faith motives. Moreover, the corporate freeze-out cases involve the use (or one might say misuse) of statutory provisions whose purpose (with some possible exceptions) is not to provide a tool for excluding minority shareholders. This use of statutory provisions

that the corporation code section allowing voluntary dissolution did not grant holders of 50% or more of the shares the absolute right to dissolve. Id. at 376-77, 317 P.2d at 5. Instead, the shareholders must act in good faith. Id. The court then examined the motives behind the petitioner's decision to dissolve and found it represented a legitimate attempt by a shareholder getting an insufficient return to protect his investment. Id. at 378, 317 P.2d at 6.

See, e.g., Donahue v. Rodd Electrotype Co. of New England, Inc., 367 Mass. 578, 328 N.E.2d 505 (1975) (holding shareholders in close corporations have the same fiduciary duty to each other as do partners and contrasting that to the less stringent standard covering shareholders in corporations generally). This is true of all the corporate freeze-out cases cited in supra notes 107 & 108, except for In re Security Finance Co., 49 Cal. 2d 370, 317 P.2d 1 (1957). There, a 50% shareholder filed with the corporation his consent for voluntary dissolution and thereupon petitioned the court to supervise the company's winding up. Id. at 376-77, 317 P.2d at 5.


E.g., Zahn v. Transamerica Corp., 162 F.2d 36 (3d Cir. 1947).

See UPA Revision, supra note 44, at 78 (a partner is entitled to act more in self interest than is a director).

A number of judicial opinions express the view that the purpose of short form merger statutes is to allow the parent to cash out minority shareholders of the subsidiary. See, e.g., Wilcox v. Stern, 18 N.Y.2d 195, 273 N.Y.S.2d 38, 219 N.E.2d 401 (1966); Stauffer v. Standard Brands, Inc., 41 Del. Ch. 7, 187 A.2d 78 (1962). But see Roland Int'l Corp. v. Najjar, 407 A.2d 1032 (Del. 1979) (holding the parent must have a legitimate business purpose for cashing out the minority in a short form merger).

Statutes allowing mergers (with the possible exception of those allowing short form mergers) have as their purpose the combination of two corporate entities into one rather than the exclusion of shareholders. See, e.g., Bryan v. Brock & Blevins Co., 490 F.2d 563 (6th Cir.), cert. denied, 419 U.S. 844 (1974). Even code provisions allowing voluntary dissolution generally have as their purpose the discontinuation of the company's business rather
stands in contrast to partnership dissolution at will. Partners agree to dissolution at will for the very purpose of being able to cease their association at any time. The corollary to this difference is a divergence in expectations between partners and shareholders regarding the permanence of their interest in the venture.116 Another factor is that in the corporate merger and even most of the dissolution cases the majority shareholders obtain the business without purchasing it in a liquidation sale.117 Thus, the minority shareholders lacked the ability of partners following dissolution to defend their own interests by bidding for the business. Finally, considerable disagreement exists among courts regarding whether corporate freeze-outs are allowable, at least so long as there is no deception, and the minority receives an adequate price for their shares.118

The final source one could look to in support of the Page dictum is a group of cases that has held that other terminable at will contracts cannot be ended in bad faith. It is hornbook law that all contracts impose a duty of good faith and fair dealing.119 Whether this duty qualifies the right to end a terminable at will contract, however, is the subject of considerable disagreement.120 At the heart of the controversy is the question than its continuation simply excluding some shareholders. See, e.g., Lebold v. Inland Steel Co., 125 F.2d 369 (7th Cir. 1941), cert. denied, 316 U.S. 675 (1942); Theis v. Spokane Falls Gaslight Co., 34 Wash. 2d 25, 74 P. 1004 (1944).

116. Indeed, the impermanence of a partnership versus a corporation is one factor often cited as a reason for choosing to do business in the later form. See, e.g., W. Painter, Business Planning Problems and Materials 6 (2d ed. 1984).

117. In fact, in a number of the corporate dissolution freeze-out cases, the court objected to the majority's conduct on this ground. See, e.g., Kellogg v. Georgia-Pacific Paper Corp., 227 F. Supp. 719 (W.D. Ark. 1964); Zimmerman v. Tide Water Associated Oil Co., 61 Cal. App. 2d 585, 143 P.2d 409 (1943). In Lebold v. Inland Steel Co., 125 F.2d 369 (7th Cir. 1941), cert. denied, 316 U.S. 675 (1942), the directors apparently put the corporation's tangible assets up for bids. Nevertheless, they already had destroyed the company's going-concern value by failing to seek new customers.


119. See, e.g., Restatement (Second) of Contracts § 205 (1979).

of whether a good faith limit contradicts the at will term. There is substantial authority that the requirement of good faith, being an implied term, can supplement but not repeal the terms of a contract.\textsuperscript{121} Courts that refuse to accept a good faith limitation on termination at will explain that this limitation would contradict the right, since implicit in an at will term is the notion that there is no review of reasons for the action.\textsuperscript{122} The opposing view is that parties agreeing to an at will term do not agree to an abuse of the power.\textsuperscript{123} The issue has arisen in a number of areas,\textsuperscript{124} but especially in the context of franchise terminations\textsuperscript{125} and, with growing frequency, in termination of at will employment.\textsuperscript{126} In recent years, a number of courts have, at least under some circumstances, imposed a good faith limit on discharging at will employees.\textsuperscript{127}

On a superficial level, these cases also give strong support for the court’s warning in \textsuperscript{Page}, especially since partners have greater fiduciary


obligations to each other than do parties to a franchise, employment, or other arms-length contract. Several important factors, however, undermine this support. First, as already noted, courts by no means universally accept the proposition that a good faith limitation exists on termination of at will contracts. Moreover, a major argument for recognizing such a limit in employment and franchise cases centers upon the unequal bargaining power of the parties. Such disparity in bargaining power is not typical of partnerships. Finally, partners enjoy greater protection following dissolution than do employees or franchisees following their termination. Partners can bid for the business, thereby leaving the party requesting dissolution as the one out in the cold. Partners also have the right to have all assets, including goodwill, accounted for. This right should prevent one of the abuses in the wrongful termination cases in which the defendant discharges a commission employee or a franchise operator after he or she has built up the business merely to prevent that employee or operator from sharing future profits.

Assuming that sufficient support for the Page dictum exists, the next question is how to define bad faith dissolution. Inevitably, the definition of bad faith in this context will drift to either one of two extremes. Unless courts specify fairly narrow and clear categories of action indicating bad faith, the definition will expand into a requirement of good cause. This movement to extremes has been the experience in other areas. For example, in the corporate freeze-out cases, courts essentially have polarized between those requiring a business purpose for the minority's exclusion and those whose review consists simply of assuring the absence of deception and the minority's receipt of a fair price. Similarly, wrongful dis-

128. While the relationship between principal and agent is a fiduciary one (Restatement (Second) Agency § 1 (1958)), courts generally have treated the principal's obligation toward his agent simply as a matter of ordinary contract law.

129. See, e.g., Pugh v. See's Candies, Inc., 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981); Shell Oil Co. v. Marinello, 63 N.J. 402, 307 A.2d 588 (1973); Gelhorn, supra note 125, at 498; Blades, Employment at Will vs. Individual Freedom: On Limiting the Abusive Exercise of Employer Power, 67 Colum. L. Rev. 1404 (1967). In Aluevich v. Harrah's, 99 Nev. 215, 660 P.2d 986 (1983), the Nevada Supreme Court refused to hold that a lessor's unqualified cancellation privilege was subject to an implied covenant of good faith. It distinguished the at will employment situation as involving one party in a vastly superior bargaining position to the other. 660 P.2d at 987. It also distinguished the partnership situation, however, as involving a special element of reliance. Id.

130. See infra note 235.


133. See, e.g., Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983) (overruling Singer's
charge of employee cases either have crystalized around a few condemned categories—such as retaliatory firings in violation of public policy—\(^{134}\) and attempts to deprive commission employees of future earnings—\(^{135}\)—or else have required employers to have good cause for the termination. In addition, the practicalities of litigation dictate that unless courts confine bad faith to specified categories, the rule will turn into a good cause requirement. If a partner dissolves the firm but continues in the business, tactically he must show a legitimate reason to be dissatisfied with his partner or else face the inevitable inference that he acted in bad faith.

Of course, one problem with a good cause requirement is that, instead of qualifying, it completely contradicts the notion of dissolution at will. The only specific category, however, suggested by Page as establishing bad faith in partnership dissolutions, is the situation in which the partner seeks to acquire the business at an inadequate price.\(^{137}\) This position’s ultimate logic would make intention irrelevant and simply command a review of whether the price was fair. After all, if the partner paid a fair price, it hardly should matter whether he dissolved in the hope of paying less. If the price is unfair, it would, as a practical matter, be impossible for the partner to prove that he never intended that result. However courts define bad faith, the next question becomes whether they can ascertain its presence at an acceptable cost with reasonable accuracy. Defining bad faith as the absence of good cause to dissolve introduces all the expense and uncertainty of any fault based system. Admittedly, hindsight review to determine whether justifiable grounds or business purpose test); Yanow v. Teal Indus., 178 Conn. 262, 422 A.2d 311 (1979).

\(^{134}\) See, e.g., Smith v. Atlas Off-Shore Boat Serv., 653 F.2d 1057 (5th Cir. 1981); Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980); Nees v. Hocks, 272 Or. 210, 536 P.2d 512 (1975); Frampton v. Central Ind. Gas Co., 260 Ind. 249, 297 N.E.2d 425 (1973); Petermann v. Teamsters Local 396, 174 Cal. App. 2d 184, 344 P.2d 25 (1960). By and large, these cases do not rely upon an implied covenant of good faith. Indeed, some cases recognizing a cause of action for wrongfully discharging an employee in contravention of public policy specifically refuse to hold that termination of at will employment is subject to a good faith limitation. See, e.g., Brockmeyer v. Dun & Bradstreet, 113 Wis. 2d 361, 335 N.W.2d 834 (1983).


\(^{137}\) 55 Cal. 2d at 197, 359 P.2d at 45, 10 Cal. Rptr. at 647.
malevolent purpose prompted an individual’s action is an increasingly accepted feature of our litigious society. Yet, it is one thing to undertake such a task in the ordinary tort or contract case involving more or less discrete transactions. It is quite another matter to attempt to ascertain which individual was really more responsible for the break-up of an ongoing relationship between persons working closely together. Indeed, in the not completely dissimilar context of marital dissolution, all states have abandoned the task and instead allow no-fault divorce. The added uncertainty resulting from a system in which courts second guess whether a partner dissolved in bad faith or with good cause creates another impact. It will make a partner planning to continue in the field less willing to dissolve the firm. Whether this unwillingness is good or bad may depend upon one’s point of view. It seems questionable under economic wisdom, however, to interfere unnecessarily with attempts by partners to seek more harmonious or efficient ownership groupings. After all, partners have an incentive not to break up an economically efficient combination of owners—which is the reason the partners initially formed the firm. In addition, had they desired, the partners could have imposed limitations on such freedom of action as a precondition for their joining the venture. For these reasons, defining bad faith as paying an unfairly low price would appear the better approach. Use of appraisal testimony by courts to value partnerships as well as other business entities is extremely common. Of course, the best evidence of a fair price is normally that set by an arms-length sale. Since partnership liquidation involves such a sale, the only possibility of an unfairly low price occurs in the two situations outlined earlier: (1) the well-healed versus strapped partner scenario, and (2) the unaccounted for intangibles problem. Yet, in the latter situation, one cannot determine whether the price is unfairly low without establishing whether the partner appropriated intangible assets belonging to the firm. If a partner appropriated such assets, however, he must account for their value irrespective of the cause of dissolution, and the

140. For a general discussion of methods that courts and appraisers use to value businesses and interests therein, see Haynsworth, Valuation of Business Interests, 33 Mercer L. Rev. 457 (1982).
142. See supra notes 45-53 and accompanying text.
143. See infra note 235.
dictum about bad faith adds nothing. This leaves a fair price review only relevant to protect a financially strapped partner. This situation, in fact, was the defendant’s claim in *Page*.

Relevant to the bad faith approach is the question of appropriate remedy. *Page* suggested that a bad faith dissolution would be wrongful within the meaning of section 38(2) of the UPA.\(^\text{144}\) The problems with applying this section to dissolution of a partnership at will were discussed above.\(^\text{145}\) Beyond these problems, it seems disproportionate to apply section 38(2) if bad faith simply means paying an inadequate price. A sufficient remedy in this case would be to pay the difference. The flip side is, if damages are the exclusive remedy, this approach would in large part define bad faith de facto as paying an inadequate price. This logic applies because if a partner dissolved without good cause or with other ill motives, but paid a fair price, there usually would be no damage.\(^\text{146}\)

**In-Kind Distribution to the More Deserving Partner.** A more radical alternative to prevent freeze-outs in liquidation sales is to eliminate such sales. Instead, the court could order a distribution of all the business assets to the partner who is more equitably entitled to carry on the venture and provide an appraised buy-out price for the other. In fact, some courts have followed this approach. Prior to the UPA, a number of decisions held that the trial court has discretion following dissolution to order either the sale of the partnership’s assets or instead divide them between the partners.\(^\text{147}\) These decisions explain that normally, the trial judge should exercise his discretion to favor a sale as the fairer solution.\(^\text{148}\) Occasionally, however, courts have held that it is more equitable to order an in-kind distribution.\(^\text{149}\) Typically, the in-kind distributions occurred in

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144. 55 Cal. 2d at 197, 359 P.2d at 45, 10 Cal. Rptr. at 647. *Page* only cited section 38(2)(a). This provides the wronged partner with the option of electing to liquidate under section 38(1) and also to receive damages from the wrongfully dissolving partner. Section 38(2)(b) grants the wronged partner the option to continue the business without liquidation. \(^\text{145}\) See supra notes 74-82 and accompanying text.

146. See, e.g., Rosenthal v. Gould, 273 Cal. App. 2d 239, 78 Cal. Rptr. 244 (1969); Mills v. Electric Auto-Lite Co., 552 F.2d 1239 (7th Cir.), cert. denied, 434 U.S. 922 (1977) (no damage to minority shareholders cashed out in a merger if they received a fair price). A possible exception exists if, prior to dissolution, the excluded partner received a salary for working for the firm. In this event, damages along the lines awarded for bad faith termination of employment might arguably be appropriate even if the partner received a fair price for his interest. For example cases discussing the measure of such damages, see, e.g., Cole v. Fair Oaks Fire Protection Dist., 43 Cal. 3d 148, 233 Cal. Rptr. 308 (1987); Sides v. Duke Univ., 74 N.C. 331, 335 S.E.2d 13 (1985); Renteria v. County of Orange, 82 Cal. App. 3d 833, 147 Cal. Rptr. 447 (1978).

147. See, e.g., Ruggles v. Buckley, 158 F. 950 (6th Cir. 1908); Kelley v. Shay, 206 Pa. 208, 55 A. 925 (1903); Harper v. Lampin, 33 Cal. 641 (1887).


149. See, e.g., Ruggles v. Buckley, 158 F. 950 (6th Cir. 1908); Kelley v. Shay, 206 Pa. 208,
situations in which the partnership owned fungible assets (such as stocks and bonds) subject to equal division between the partners\textsuperscript{160} or in which it held real property subject to physical partition without loss of value.\textsuperscript{181} While the principal criterion in most of these cases seems to have been administrative convenience, at least one court\textsuperscript{182} appeared motivated by concern about the prejudice to a partner who would have been at a disadvantage in bidding for the assets.

As explained below, the UPA should preclude this choice and require selling the assets unless there is a contrary agreement by all the partners. Nevertheless, a surprising number of courts, demonstrating a curious detachment, have continued to adhere to the view that they are entitled to do whatever they find equitable.\textsuperscript{183} Indeed, at least two of these decisions have gone beyond the pre-UPA cases to order the entire business distributed to one partner (or group of partners) who then pay the other partner the appraised value of his interest.

The first of these two cases is \textit{Rinke v. Rinke}.\textsuperscript{184} This lawsuit involved three brothers who conducted two partnerships: a car dealership and a hardware business.\textsuperscript{185} General Motors' refusal to allow the dealership to continue selling four different lines of cars (Cadillac, Buick, Pontiac and Chevrolet) precipitated a dissolution.\textsuperscript{186} The trial court ordered distribution of the assets of the car dealership to two of the brothers, who had negotiated separate agencies (one for Buicks and Chevrolets, the other for Pontiacs and Cadillacs) with General Motors.\textsuperscript{187} The third brother evidently received the hardware business, but, as this business was the less profitable endeavor, the third brother complained that the dealership

55 A. 925 (1903).
150. See, e.g., Ruggles v. Buckley, 158 F. 950 (6th Cir. 1908) (stock).
151. See, e.g., Watterson v. Knapp, 35 Cal. App. 2d 283, 95 P.2d 154 (1939). Prior to the UPA, the prevailing American rule of limited conversion complicated the distribution of real property following dissolution. Under this view, courts would treat real property as personal property and order its sale only as necessary to pay firm debts. Any surplus retained its character as real property in which surviving partners and heirs of deceased partners took title as tenants in common. See generally I. ROWLEY, ROWLEY ON PARTNERSHIP 713-17, 727-29 (1960).
155. 48 N.W.2d at 203.
156. Id.
157. Id.
should have sold its assets. The Supreme Court of Michigan rejected this contention. It asserted that nothing in the UPA requires the court to order the assets of a dissolved partnership sold, particularly when the partnership needs to pay no debts from the proceeds, and no one other than the former partners was interested in their purchase.

In Nicholes v. Hunt, the Oregon Supreme Court took Rinke one step further. In this case, two partners conducted a business that manufactured lead shot for shotgun shells. Dissention between the partners led to their seeking dissolution. The trial court awarded the business assets to defendant and ordered him to pay plaintiff for plaintiff's interest. On appeal, the supreme court rejected plaintiff's contention that if he did not receive the business, the trial court must order the assets sold. Quoting Rinke, the court held that if the partnership had already paid its debts, the trial court could distribute the assets in kind. It then upheld the trial court's decision to give the business to defendant, whom it found had a greater equitable claim.

This approach presents some serious problems. First, this approach is contrary to the UPA. Section 38(1) grants each partner the right to demand application of the firm's assets to payment of its debts and distribution of the surplus in cash. The drafters of this section intended this language to clarify that the partnership must sell its assets. Further, it

158. Id. at 204.
159. Id. at 207.
160. Id.
162. 541 P.2d at 822.
163. Id.
164. Id. at 824-25.
165. Plaintiff asserted that he was entitled to continue the business under UPA § 38(2) because the defendant acted wrongfully in dissolving. 541 P.2d at 826-27.
166. Id. at 828.
167. Id. at 828-29.
168. See supra note 41.
169. See UPA § 38 comment (West 1969 & Supp. 1988); Lewis, The Uniform Partnership Act, 24 Yale L.J. 617, 629 (1915). In Young v. Cooper, 203 S.W.2d 376 (Tenn. App. 1947), the court specifically rejected the argument by two partners that they were equitably entitled to buy out the third partner and continue the business without liquidation. Id. at 386. The two partners based their equitable claim upon the facts that they owned 82% of the business and they had taken plaintiff into the business after they were already operating it. Id. The court held the UPA required liquidation. Id. One might argue that the exact language of section 38(1) does not command liquidation so long as no debts are outstanding and the partner not receiving the business gets a cash payment for his interest. See Dreifuerst v. Dreifuerst, 90 Wis. 2d 566, 280 N.W.2d 335 (1979) (rejecting the argument). In this event, no partner is forced to receive firm assets in kind, thus seemingly fulfilling the command of the section that each partner may demand payment in cash. There are two difficulties with this argument. First, it ignores the negative implication of section 38(1). By stating
may not solve the freeze-out problem. The partner receiving the business must pay the other partner the value of his or her interest.\textsuperscript{170} Also, the partners must pay off all the firm's creditors since courts will not award an in-kind distribution when outstanding debts exist.\textsuperscript{171} Yet, one of the two causes of freeze-outs in liquidation sales is that one partner lacks the necessary payoff funds.\textsuperscript{172} In addition, it would hardly help to award the tangible assets of a partnership to one partner if the other has a lock on a key intangible—such as owning the location of the business as in \textit{Cude v. Couch}\textsuperscript{173}—without which the business could not continue. Most importantly, this approach yields undesirable results. It is uncertain precisely how the court will decide which partner has the greater entitlement to continue the venture. The court might consider who contributed more to the business' success.\textsuperscript{174} Probably, the court and parties will focus upon who was most responsible for causing the dissolution.\textsuperscript{175} Both subjects are likely to be in hot dispute.\textsuperscript{176} It is totally presumptuous to believe that out of conflicting testimony and with only the vaguest, if any, standards for a guide, courts can determine which partner is truly deserving of continuing the enterprise.\textsuperscript{177}

If a partner cannot afford to pay the fair market value for the firm's assets (including goodwill), by definition he cannot afford to discharge its debts and pay the other partner the value of the other partner's interest.\textsuperscript{178} The court in \textit{Nicholes}, the court pointed to the fact that defendant had conceived of the machinery and method of operation prior to taking plaintiff into defendant's business as a partner. 541 P.2d at 828.

The court in \textit{Nicholes} also noted that plaintiff had not always been attentive to the business or heeded the decisions of the defendant, who was the managing partner. \textit{Id.} at 822. In addition, the plaintiff was late in making a payment for his interest. \textit{Id.} at 822.

In \textit{Nicholes}, defendant excluded plaintiff from the business after the two partners apparently had patched up their differences. \textit{Id.} Not only does this suggest some competing equities between the parties, but a number of courts have held that such an exclusion constitutes wrongful conduct entitling the excluded partner to continue the business under section 38(2).\textsuperscript{179} See supra note 61.

In cases in which partners have sought to dissolve partnerships for a term by claiming wrongful conduct on the part of other partners, courts have repeatedly noted what a difficult task it is to resolve which partner is more at fault. See infra note 266. Attempting
Rinke provides a good illustration of these problems. At first glance, the court seems sensible in awarding the dealership assets to the two brothers since they had obtained the new franchises. Yet, it is difficult to agree with the court that the brothers did not breach their duty to the partnership in individually taking the new agencies.178 True, General Motors would no longer allow the partnership to sell four different lines of cars.179 But, why could the partnership not continue to sell two lines of cars under one of the new franchises rather than the two brothers’ taking both agencies for themselves?180 The court then compounded the problem by ordering an in-kind distribution over the objection of the third brother. The third brother may well have calculated that if he had purchased the location, General Motors would have cancelled his brothers’ franchises and given him an agency. At the very least, he could have forced his brothers to bid generously, since if they lost their location, General Motors may well have terminated their franchises. Instead, the third brother received an appraised value of the dealership’s assets in which the court listened to the two brothers’ appraisers over his.181 To top it off, the court refused to recognize any value for goodwill (since the partnership lost its franchise).182 The end result of the Rinke court’s decision to distribute the business in kind, therefore, may well have been to aid in a freeze-out.

A Solomon-Like Solution. A third alternative moves completely away from fault and equities. Instead, a court might seek to avoid freeze-outs in dissolution and liquidation by prohibiting any partner from buying the assets unless the other partners consent. Defendant in Prentiss v. Sheffel urged essentially this approach.183 In response to plaintiffs’ freezing him out of management and thereupon suing to dissolve, defendant retaliated by arguing that the court should not allow plaintiffs to bid for the partnership’s assets.184 The court rejected the idea.185 Nevertheless, this approach has a certain Biblical wisdom. It seemingly avoids freeze-outs without the need to determine who, if anyone, is at fault. Moreover, much

178. 48 N.W.2d at 205-06.
179. Id. at 203.
180. This presumably would have meant giving up the other agency since a partner’s fiduciary duty normally precludes him from competing with the partnership. E.g., Shulkin v. Shulkin, 301 Mass. 184, 16 N.E.2d 644 (1938).
181. 48 N.W.2d at 207.
182. Id. at 206-07.
184. 513 P.2d at 952.
185. Id.
186. Id. at 953.
as in the famous story of Solomon’s decree in the dispute between the two mothers,\(^{187}\) the hope is that a harsh judgment will spur the parties to resolve the matter. In this case, resolution may be achieved by negotiating a buy-out acceptable to both sides.

Despite the court’s assertion to the contrary in *Prentiss*,\(^{188}\) some judicial authority, in fact, supports this approach. A number of turn-of-the-century opinions state that a partner cannot buy partnership assets in a liquidation sale and that any such sale is voidable.\(^{189}\) The opinions further state that this holds true regardless of whether the sale is private or public\(^ {190}\) and whether or not the price is fair.\(^ {191}\) The reasoning behind these statements is that a partner winding up a partnership following dissolution stands in the position of a trustee (with the partnership assets constituting the trust res).\(^ {192}\) He or she thus falls within the loyalty rule preventing trustees from purchasing trust property.\(^ {193}\)

These cases are of questionable authority today. A partner desiring to buy partnership assets may avoid the restriction by requesting the court to appoint a receiver to wind up the partnership and sell its property.\(^ {194}\) Sale by a receiver eliminates the conflict of interest problem created by a partner selling to himself.\(^ {195}\) Nevertheless, a trial court has discretion over whether to appoint a receiver.\(^ {196}\) While no reported decision has done so, the court could refuse to appoint a receiver for this purpose. Very likely the court also has the discretion to refuse to allow partners to bid for the assets even if there is a receiver.\(^ {197}\) Whether or not the court should exer-

\(^{187}\) 1 Kings 3:16-28.

\(^{188}\) 513 P.2d at 952.

\(^{189}\) E.g., Didlake v. Roden Grocery Co., 160 Ala. 484, 49 So. 384, 386 (1909); French v. Vanalita, 83 Ark. 306, 104 S.W. 141, 142 (1907); Rowell v. Rowell, 122 Wis. 1, 99 N.W. 473, 477 (1904); Valentine v. Wysor, 123 Ind. 47, 23 N.E. 1076, 1079 (1890).

\(^{190}\) E.g., Valentine v. Wysor, 23 N.E. 1076, 1079 (Ind. 1890).

\(^{191}\) See Rowell v. Rowell, 122 Wis. 1, 99 N.W. 473, 477 (1904).

\(^{192}\) E.g., Valentine, 23 N.E. at 1079.

\(^{193}\) E.g., G. BOGART, TRUSTS § 95, at 343 (6th ed. 1987).

\(^{194}\) E.g., James v. Wade, 200 Ark. 786, 141 S.W.2d 13, 15-16 (1940).

\(^{195}\) Id.


\(^{197}\) *Prentiss* is not to the contrary. The court there simply held that the trial judge acted within his discretion in allowing partners to bid. 513 P.2d at 953. The court did not hold that the judge would have abused his discretion had he refused to do so. In Hankin v. Hankin, 507 Pa. 603, 493 A.2d 675, 679 (1985), the court stated that a partner had "the right" to bid on firm property. The court made this statement, however, in the context of explaining why the liquidating partner's interest in buying the firm's property placed him in a conflict of interest. The thrust of the remark is to justify the trial court's appointment of a receiver rather than to address whether the trial court could have refused to accept bids from partners. Indeed, the court notes without evident disapproval an order by the trial judge that refused to allow partners to bid on one parcel of partnership property. 493 A.2d at 679.
cise its discretion in such a manner is a different question.

First, this approach may not solve more than half of the freeze-out problems. It would deter the well-healed individual who attempts to take advantage of a financially strapped partner. It might not, however, prevent freeze-outs based upon appropriation of key intangibles. A partner who has a hold on a key intangible could often simply buy new tangible assets (such as the washing machines in Cude v. Couch\textsuperscript{198}) if the law prevented him from purchasing the partnership's assets.\textsuperscript{199}

In addition, this approach could result in a loss of wealth not only for the partners but for society as a whole. Normally, outsiders are not willing to pay as much for the business as the partners would pay.\textsuperscript{200} Indeed, no outsider may even be willing to continue the business. The strategy behind this approach is that lack of generous outside bids creates mutual self interest that will convince the partners to reach a satisfactory settlement. The partners, however, may miscalculate in their negotiation, or one partner may not act with purely rational economic motives. Thus, it may be a bit harsh to hold each partner hostage to the other's irrationality. A societal loss also follows if this approach results in the destruction of viable enterprises.

Removing Handicaps to Effective Bidding. Perhaps the underlying flaw in the three prior approaches is that they do not focus on the heart of the problem. Is there any way to attack directly the two factors that prevent bidding between the partners from always precluding a freeze-out? The first concern is that a well-healed partner will outbid a financially strapped one.\textsuperscript{201} Providing each partner with access to an adequate source of funding is the most direct response to this situation. This approach is not as far-fetched as it sounds. Normally, each partner expects the future earnings of the business ultimately to pay for the purchase.\textsuperscript{202} Partners, therefore, do not need extensive personal funds if they have adequate time or credit. Partners could seek financing from commercial lending sources, but such efforts might not always meet with success.\textsuperscript{203} In that

\textsuperscript{198} 588 S.W.2d 554 (Tenn. 1979), discussed supra notes 49-53 and accompanying text.

\textsuperscript{199} Cude also illustrates one method by which partners might seek to circumvent a restriction upon their bidding. Couch employed one Platkin to bid for the partnership's equipment without indicating Platkin was acting on behalf of Couch. 588 S.W.2d at 555. In addition to acting as undisclosed principals, partners precluded from bidding might seek to purchase the assets from the successful outside buyer.

\textsuperscript{200} E.g., Bromberg, supra note 44, at 647-48.

\textsuperscript{201} See supra notes 45-48 and accompanying text.

\textsuperscript{202} Cf. Z. Cavitch, TAX PLANNING FOR CORPORATIONS AND SHAREHOLDERS 7-11 (1987) (discussion of tax advantages of corporation versus fellow shareholder buying out selling shareholder based upon tacit assumption that purchase money normally comes from the corporation).

\textsuperscript{203} E.g., Hilman, supra note 139, at 71.
event, why could the court not allow an installment payment in the liq­
uidation sale? In fact, under the bad faith dissolution dicta in Page, the
wronged partner presumably could post a bond pursuant to section 38(2)
rather than immediately pay the dissolving partner for his interest. 204
Such a bond involves a far greater delay in payment than an installment
sale since the continuing partner need not actually return the dissolving
partner’s capital until the continuing partner decides to end the firm. 205
No reason exists to believe courts lack the power to order installment
sales of partnership property. Courts have broad discretion in carrying
out judicial sales. 206 These sales in other fields have allowed installment
payments. 207 Indeed, several partnership dissolution cases upheld orders
that did precisely this in selling firm assets. 208
Along similar lines, courts might attempt to prevent a partner from ap­
propriating intangible assets. To the extent the partner obtained the
intangible by usurping a partnership opportunity (for example, by purchas­
ing the building leased by the partnership209 or by entering into a new
lease in his own name for the partnership’s premises210), then courts
properly can order the partner to turn over the asset for sale in the liq­
duation.211 Courts might go beyond this, however, to require a partner with
a legitimate hold on an intangible (for example, by owning the firm’s
premises as in Cude v. Couch212) to make it available. Courts could, if

204. See supra note 144 and accompanying text.
205. See supra note 56 and accompanying text.
Stilinovich, 268 N.W.2d 541, 544 (Minn. 1978); Goergen v. Nebrich, 4 A.D.2d 526, 527, 167
207. E.g., United States v. Heasley, 283 F.2d 422 (8th Cir. 1960) (approving a judicial
sale of real estate to pay a tax lien when the purchase price was to be paid off over five
years); Matthews v. Ealinge, 41 Tenn. App. 116, 292 S.W.2d 543 (1955) (allowing install­
ment sale of real property); Kentucky Utils. Co. v. Steenman, 283 Ky. 317, 141 S.W.2d 225
(1940) (holding a judicial sale of the property of a corporation in receivership for a payment
of $500 deposit and the remainder in six months was proper); Fidelity Ins. Trust & Safe
Deposit Co. v. Roanoke Iron Co., 84 F. 752 (W.D. Va. 1897) (confirming a judicial sale of a
plant in receivership when a portion of the price was to be paid at a later date).
208. See Maras v. Stilinovich, 268 N.W.2d 541 (Minn. 1978) (held that the court may
allow the sale of firm assets to a partner on an installment basis); Skemmer’s Appeal, 58 Pa.
168, 179 (1877) (court ordered property sold to the partner with the highest bid “to be paid
within a reasonable time”); see also Hankin v. Hankin, 507 Pa. 603, 453 A.2d 675, 678
(1983) (liquidating partner undertook negotiations to sell assets on installment basis with
apparent approval of trial court).
2d 239, 75 Cal. Rptr. 244 (1969); Meinhard v. Salmon, 249 N.Y. 458, 154 N.E. 545 (1928).
212. 588 S.W.2d 554 (Tenn. 1979), discussed at supra notes 49-53 and accompanying
text.
faced with the situation presented in Cude, order the partner to give the purchaser a lease of the firm’s assets. Indeed, one older opinion went so far as to forbid partners from competing with the purchaser of the business.213

The problem with these approaches is that they radically alter the parties’ contract in a manner highly prejudicial to the departing partner. Allowing time payments in a liquidation sale not only delays return of the departing partner’s capital (which he may need to enter a new venture), but the departing partner remains liable for pre-dissolution partnership debts until payment of sufficient installments to allow their satisfaction.214 At the same time, the partner lacks the protection of being an owner able to exercise control over the firm. Similarly, even if the departing partner receives compensation for entering a lease or a noncompetition agreement, his freedom of action is dramatically constrained in a way for which he never bargained. Moreover, this solution creates some rather perverse incentives. For example, suppose an individual needed capital to start a business. He could bring a well-healed partner, later dissolve the firm, ask the court to sell the assets on installment payments and thereby turn his partner into an involuntary creditor. Indeed, the suspicion that the partner may have planned this scenario from the start leads one to scrutinize the dissolution for evidence of bad faith.

Assuring a Fair Price. The undesirable effects of the preceding four approaches suggest that it may be necessary for the courts to set a more modest goal. Courts could forgo trying to ensure that a partner does not exploit his advantage to exclude another from the business. Instead, they could simply seek to guarantee that the departing partner receives a fair price. In fact, this seems to be the approach of most courts.215

Accomplishing this more modest task requires focusing again on the two factors that can prevent bidding between the partners from establishing a fair price. The first factor lies in the inability of a financially strapped partner to offer a reasonable price for the firm’s assets.216 Courts could respond to this situation by refusing to confirm a sale to the well-healed partner, even if his bid is the highest, unless they find by evidence beyond simply the auction result that this constitutes a fair price. Man-

213. Williams v. Wilson, 4 Sand. Ch. 379, 381 (N.Y. Ch. 1846).
214. See UPA § 36 (West 1969 & Supp. 1988). Creditors, however, cannot complain about this delay in payment. They lack the liquidation right under § 38(1) (which does not apply if partners agree otherwise). See supra note 41. Creditors’ protection lies in §§ 36 & 41.
215. This is evident from the fact that none of the preceding approaches seems to have drawn overwhelming support.
216. See supra notes 45-48 and accompanying text.
dell v. Centrum Frontier Corp.217 provides a good illustration of this approach. The court in Mandell dissolved a real estate limited partnership due to deadlock and losses.218 The court then ordered the firm’s property sold in a judicial sale. Two prospective bidders, an outsider and plaintiff limited partners, attended the sale.219 Over the objection of the limited partners, the court would not confirm a sale for less than thirty million dollars.220 (This was one million dollars more than the price placed on the property by one of defendant general partner’s expert witnesses.)221 The outsider declined to bid this high, but the limited partners acquiesced to the floor set by the court and bought the property.222

The authority of courts to undertake this approach rests on two grounds. First, unless the partners agree on a method of sale, a public judicially supervised sale is necessary.223 Courts have broad discretion in conducting such a sale,224 which easily encompasses setting a minimum bid.225 The partners’ fiduciary duty strengthens the court’s power to reject their bid if the bid is below a level the court considers fair. The UPA specifically requires partners to account for profits made in connection with the liquidation of a partnership.226 This strongly indicates that partners must not pay an unfairly low price. Moreover, the rationale behind allowing partners to bid in a liquidation sale, despite their conflict of interest, is that judicial supervision will ensure a fair price.227

Nevertheless, this approach faces several objections. One might argue that the highest bid in a public sale is by definition a fair price.228 When all partners can compete, this is no doubt true. This view is unrealistic, however, when one partner lacks the funds to bid what he considers a fair price. The reticence of outsiders to pay full going concern value for a small business, at least in a forced liquidation, is well recognized.229 One

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218. Id. at 827.
219. Id. at 821.
220. Id. at 828.
221. Id. at 831.
222. Id. at 831-32. See also Hankin v. Hankin, 507 Pa. 603, 493 A.2d 675, 679 (1985) (examples of trial court approval and rejection of bids for partnership property); James v. Wade, 200 Ark. 786, 141 S.W.2d 13, 16 (1940) (trial court appointed appraisers and issued an order that the partnership’s property would not be sold for less than the appraised price).
224. See supra note 206.
228. See, e.g., Cude v. Couch, 588 S.W.2d 554, 556 (Tenn. 1979).
229. See Bromberg, supra note 44, at 647-48. See also G. GOULD & D. CODDINGTON, How
might also ask what happens after a court rejects the highest bid. If a partner refuses to increase his bid to a level the court considers fair, the court might further advertise the property and seek other buyers. Ultimately, however, the court could confront the necessity of confirming a sale to an outsider even at a lower price. This is similar to the approach discussed previously suggesting the court could refuse to allow partners to buy the assets unless all consent. Here, however, the result is less harsh. The partner can avoid the barrier by either negotiating with the other partner or by paying a price the court considers fair. Also, even if an outsider gets the property for less than a partner bid, partners have a fiduciary obligation, not shared by outsiders, to pay a fair price. Events are extremely unlikely to get this far, however. As in Mandell, a partner desiring the business is almost always going to meet the court's minimum bid. As a result, the end effect of this approach is to create something approximating a negotiated rather than forced sale, with the court acting as a surrogate for the seller.

This approach cannot solve the second factor's precluding effective bidding between the partners. This occurs when a partner can obtain intangible assets of the business without paying for them. A partner can then pay a fair price for the firm's saleable assets without paying a fair price for the business as a going concern. Even if the court refuses to confirm the partner's bid for the tangible assets, he might acquire similar assets elsewhere and continue the business. Here, however, another protection comes into play. Courts can determine whether the partner appropriated an intangible asset (i.e., goodwill) belonging to the firm, and, if so, require compensation from the partner. This is nothing new. Courts have long recognized claims based upon the appropriation of partnership goodwill following dissolution. Under this approach, for example, the court should have charged the defendant in Cude v. Couch with the value of

Do You KNOW WHAT YOUR BUSINESS Is WORTH? (Small Business Administration Management Aids No. 156, 1964).


231. See supra notes 183-200 and accompanying text.

232. See generally I. Rowlev, supra note 151, at 518.

233. The court has no incentive to set an unrealistically high minimum price. In the rare case in which a court might nevertheless do so, the lack of outside bids reaching this level should provide an incentive for the partners to negotiate their own fair price.

234. See supra notes 49-53 and accompanying text.


236. 588 S.W.2d 554 (Tenn. 1979), discussed supra notes 49-53 and accompanying text.
goodwill obtained because defendant continued pursuing the business in the same location.

For this protection to be effective, courts must overcome two problems. First, courts must reject the view of some older decisions that tested whether the partnership possessed any valuable goodwill by determining if the partnership could sell the goodwill after the dissolution. The freeze-out based upon unaccounted for intangibles often occurs precisely because one partner possesses a grip on the goodwill that prevents its sale. The fact that one cannot sell goodwill does not make it less real or the partner's appropriating it any less unjustly enriched. Fortunately,

237. E.g., Spalding v. Spalding’s Adm’r, 248 Ky. 259, 58 S.W.2d 356, 358 (1933); In re Brown, 242 N.Y. 1, 160 N.E. 581, 584 (1926); Salter v. Condon, 236 Ill. App. 17 (1925). Salter provides an interesting illustration of this approach. The court refused to find that a partnership’s operating a golf course possessed any goodwill. The court reached this result because defendant owned the land upon which the partnership built the course and defendant was under no obligation to lease this land to anyone continuing the business. Hence, there was no saleable goodwill since a purchaser would have no guarantee of being able to continue the business. But see Vercimak v. Ostoich, 118 Utah 253, 221 P.2d 602, 604 (1950) (The partnership operated a tavern in a location owned by the defendant partner. The court held that the absence of a lease did not preclude the existence of goodwill when defendant continued to operate the tavern in the same location after dissolution.).

The Salter opinion creates a series of anomalies. First, what happens if the partner owning the property does not wish to continue the business after dissolution, but instead is willing to lease the property to an individual buying the business as a going concern? In that event, the buyer presumably will pay for the goodwill. Is the partner owning the property entitled to all of this payment? If not, how can he be entitled to appropriate the goodwill by simply choosing to continue the venture himself? Further, if a third party owns the location leased by the firm, a partner can neither purchase the property for himself (e.g., Lavin v. Ehrlich, 80 Misc. 2d 247, 363 N.Y.S.2d 50 (1974)), nor renew the lease for his own benefit (e.g., Fulton v. Baxter, 596 P.2d 540 (Okl. 1979)) without offering the opportunity first to the firm or compensating it for the goodwill thus appropriated. It seems inconsistent with this solicitude for partnership goodwill for the law to hold that a partner already owning the premises is free to appropriate, without paying any compensation, the goodwill coming from continuing the business in that location. Finally, assume a partnership uses its funds to construct improvements on property owned by one partner but leased to the firm. Courts hold that the partner owning the property must compensate, after dissolution, the other partner for his share of the improvement’s worth. E.g., Gauldin v. Corn, 596 S.W.2d 329 (Mo. App. 1980); Minikin v. Hendrix, 15 Cal. 2d 338, 101 P.2d 474 (1940); Marston v. Marston, 277 Mass. 129, 177 N.E. 883 (1931). But see Kirby v. Kalbacher, 373 Pa. 103, 195 A.2d 535, 537 (1953) (did not require accounting for improvement to leasehold). Under Salter, however, the fact that partnership funds created goodwill attached to the property received no recognition.

In defense of Salter, it might be argued that the nonowner partner could have demanded a long-term assignable lease. See Comment, Partnership—No Good-Faith Requirement for Dissolution, 11 Mem. St. U.L. Rev. 143, 148 (1980). This, however, injects a need for distrust between the partners from the inception of the venture that is inconsistent with a fiduciary relationship.
more recent decisions reject this test.238 A more difficult problem is to separate partnership goodwill from the personal skills and abilities of individual partners. Older opinions often concluded that professional or personal service partnerships lacked firm goodwill.239 More recent decisions have shown a willingness to find goodwill owned by the business rather than just its members.240 Resolving this issue is well beyond the scope of this Article. The fact that partners in personal service or professional firms normally compete freely on their own merits for clients following a breakup makes this problem less acute. Courts might simply take the position that normally there has been a reasonable in-kind distribution to the partners of whatever goodwill the firm possessed.241

The approach of focusing only on a fair price raises two final questions. Initially, how does this approach differ from defining bad faith dissolution to equal the paying of an unfairly low price?242 Perhaps the end result may be largely the same.243 Yet, speaking in terms of bad faith can confuse lower courts and litigants. The opinion in Rosenfeld, Meyer & Susman v. Cohen,244 illustrates the problem. Two partners in a law firm handled a major contingent fee antitrust lawsuit. As the suit approached favorable resolution, they dissolved the firm with the expectation that the client would retain them, and they would thereby avoid sharing the fee with the other partners. This strategy succeeded, but the other partners sued. On appeal from rulings limiting plaintiffs’ claims for breach of fidu-

238. E.g., Swann v. Mitchell, 435 So. 2d 797 (Fla. 1983); Foster v. Foster, 42 Cal. App. 3d 577, 117 Cal. Rptr. 49, 53 (1974) (the value of goodwill in a professional medical practice is not necessarily the specified amount of money that a willing buyer would pay).


241. Engle v. Vernon, 215 N.W.2d 506 (Iowa 1974), provides an illustration of this position. The court found that a partnership conducting a food brokerage business possessed goodwill. The court held, however, that the two partners effectively divided the goodwill between themselves when each continued to act as a food broker in a different one of two cities in which the firm had done business. Id. at 514. In the typical professional partnership dissolution, there may not be this clean geographical division. Still, each partner has an advantage in retaining the clients he serviced. Hence, there will naturally occur a roughly equitable distribution of the goodwill. Of course, this solution cannot apply when a partner retires or dies, but that does not relate to the freeze-out problem.

242. See supra note 137 and accompanying text.

243. This depends upon what remedy the court awards upon finding a bad faith dissolution. If the court simply grants damages, the result is the same. If the court applies section 38(2), however, then the sanction for bad faith dissolution goes far beyond demanding payment of a fair price. See supra note 56 and accompanying text.

ciary duty, the court of appeals held plaintiffs had stated a cause of action for bad faith dissolution.\textsuperscript{246} Tempting, however, as it is to castigate defendants for their lack of scruples, the court’s reliance upon their bad faith is at best gratuitous and may be dangerously misleading. Had the firm dissolved for completely innocent causes (for example, the death of a partner), the partners should still have shared the fee. Indeed, the court held that the antitrust suit constituted unfinished business of the firm, which means sharing the fee regardless of the presence or absence of bad faith in dissolution.\textsuperscript{246} Yet, by speaking of bad faith, the court no doubt encouraged the litigants to waste their time disputing over defendants’ motives. Such inevitably will be the result if courts speak about bad faith when all they really wish to do is demand partners pay a fair price.

The more fundamental question is whether only acting to ensure a fair price provides a just result. This question has provoked considerable controversy in the context of corporate freeze-outs.\textsuperscript{247} Without resurrecting this entire debate, it is useful to compare the potential harms to partners cashed out at a presumably fair price with potential harms to shareholders. Critics of allowing involuntary cash-outs of minority shareholders even at a so-called fair price point to a number of harms the shareholders still suffer.\textsuperscript{248} These harms include tax burdens,\textsuperscript{249} the burden of seeking new investments,\textsuperscript{250} defeated expectations,\textsuperscript{251} and the possibility of a low

\textsuperscript{245} Id. at 211, 213, 194 Cal. Rptr. at 186, 187.
\textsuperscript{247} Compare Borden, supra note 1, at 1039 (central issue is whether shareholders get a fair price) with Brudney & Chirelstein, supra note 1, at 1365-70 (courts should not allow going private freeze-outs even for a purportedly fair price). See generally R. CLARK, supra note 21, at 504-09.
\textsuperscript{248} See generally R. CLARK, supra note 21, at 504-09; Vorenberg, supra note 1, at 1202-03.
\textsuperscript{249} A shareholder must, of course, recognize as income any gain upon receiving cash for his shares. I.R.C. § 1001 (West 1988). At first thought, one is tempted to suspect that a shareholder who complains about paying tax on his profit from cashing out is crying crocodile tears. Yet, the loss of control over the timing of the disposition that results from a freeze-out deprives the shareholder of the ability to engage in often advantageous tax planning. This includes holding the shares until death when they obtain a stepped up basis. See id. § 1014.
\textsuperscript{250} While the search costs for new investments may not be that great for the small shareholder in a public corporation, in a closely held company the shareholder often has other important relationships (e.g., employment) with the firm that he may lose in a freeze-out. Vorenberg, supra note 1, at 1203.
\textsuperscript{251} The counter-expectation effect of a corporate freeze-out flows from the fact that it must employ provisions of the corporation codes for a purpose different than their intended use. See supra notes 114-15 and accompanying text.
price due to the control of timing by the insiders. Two of these factors seem less apropos to partners. The flow-through principle of partnership taxation should result in less taxable gain for a partner upon being cashed out. More significantly, shareholders and members of a partnership at will have very different expectations concerning the permanence of their interest. The other two factors, however, seem at least as relevant to partners. The burden of finding a new investment may well be greater since partners often look to the firm for a job as well as an investment. Also, partners in an advantageous position might time a dissolution in a seemingly unfair manner. The defendant in Page alleged such a position. He accused plaintiff of sharing a period of losses with him only to dissolve after the firm began to show profits. Nevertheless, a fair valuation should consider future prospects of a business, thereby handling the timing problem. Also, partners implicitly accepted the burden of searching for a new business when they agreed to a partnership at will.

III. Freezing Out and Partnership Planning

A. Can Planning Help?

As discussed thus far, the UPA does a good job of preventing most of the freeze-out techniques that plague the corporate setting. A number of approaches exist to deal with the remaining tactics. Since none of these approaches, however, is without problems, it is useful to ask if partners

252. For an unusual example of such a timing ploy, see Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099 (Del. 1985) (acquirer waited to perform a take-out merger until after a contract obligating it to pay a minimum price for the minority's shares expired). More typically, however, the timing concern is that insiders will freeze public shareholders out when the stock market as a whole is in a slump or just prior to improved prospects for the company's becoming sufficiently tangible to affect either the market or an appraised price for its shares. See, e.g., Brudney & Chirestein, supra note 1, at 1368.

253. Income made by the partnership raises the partners' bases in their interests in the firm. I.R.C. § 705(a)(1)(A) & (B) (West 1988). Hence, there is less built up gain upon which partners may be taxed when disposing of their interests.

254. See supra notes 114-16 and accompanying text.

255. This may also be true in closely held corporations. See supra note 250. Minority shareholders, however, can often squeeze minority shareholders out of jobs with the company, whether or not the majority can also freeze the minority out of their shareholdings. This is not the case with partners. See supra notes 21-23 & 29-37 and accompanying text.

256. 55 Cal. 2d 192, 359 P.2d 41, 10 Cal. Rptr. 643 (1961), discussed at supra notes 45-48 and accompanying text.

257. 359 P.2d at 44, 10 Cal. Rptr. at 646.

can improve matters through advance planning and agreement.\textsuperscript{259}

Dealing with crude expulsion and misappropriation does not provide a significant opportunity for improvement. Some provisions, such as requiring multiple signatures in writing partnership checks or in withdrawing funds from partnership bank accounts,\textsuperscript{260} might be useful. Otherwise, if a partner is prepared to disregard legal constraints, there is little an agreement can do.

More success may be possible with dissolution and liquidation freeze-outs. Several ideas regarding such freeze-outs come to mind. The first is to create a partnership for a term instead of one dissoluble at will. This approach does not prevent dissolution at the behest of an individual's seeking to disassociate himself from his partner.\textsuperscript{261} Rather, it gives the other partner the right under section 38(2) to continue the business without needing to buy it in a liquidation sale.\textsuperscript{262} Unfortunately, this solution presents a couple of problems. Partners desiring to leave a partnership for a term are unlikely to yield meekly to section 38(2) treatment. Instead, they can turn to either of two tactics. They might sue for dissolution under section 32. They could claim that the other partner is acting wrongfully—specifically, that he willfully or persistently breached the partnership agreement or otherwise engaged in conduct that prejudices carrying on the business or renders it impractical to continue in association with him.\textsuperscript{263} Alternately, partners may assert that irreconcilable differences render dissolution equitable.\textsuperscript{264} Such charges will almost always have at least a grain of truth in them or else a partner would not wish to dissolve. The second tactic is to make life in the firm sufficiently miserable for the other partner so that he will dissolve, but without going so far as to be accused of wrongful conduct justifying dissolution under section

\textsuperscript{259}One planning approach lies in seeking to avoid the sources of friction that often motivate one partner to freeze-out another. For a discussion of such sources, see F. O'NEAL & J. DERWIN, supra note 2, at §§ 2.01-2.19. This type of planning is beyond the scope of this article.


\textsuperscript{261}See supra note 56 and accompanying text.

\textsuperscript{262}UPA § 31(2) (West 1969 & Supp. 1988).


32 and sanction under section 38(2). In either case, the impact of these tactics is to precipitate significant litigation over which partner is at fault in the dissolution. Litigating such disputes is not only costly, but courts have repeatedly noted that it is difficult to resolve who really is at fault. In the end, the result of establishing a partnership for a term is to create significant risk and uncertainty for partners who simply can no longer get along. Instead of dissolution at will followed by a negotiated or market set resolution of who gets the venture and what that partner pays, the matter is left to a third party’s perception as to fault. Agreeing to a term creates another problem as well. As discussed above, dissolution at will precludes certain squeeze-out techniques employed in closely held corporations. Setting a term for the partnership removes this protection.

A second possibility is a buy-sell contract. The partners may or may not accompany this by setting a term. The essential element of such an agreement is that each partner consents in advance to waive his right under section 38(1) to demand liquidation upon withdrawing from the firm. Instead, the partner receives the price set in the contract. Buy-sell agreements are useful to deal with dissolution in events such as a

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265. See, e.g., Stark v. Reingold, 18 N.J. 155, 113 A.2d 679, 683 (1955) (one partner hired a notorious gangster to pressure the other to sell out).

266. See, e.g., Schymanski v. Conventz, 674 P.2d 281, 287 (Alaska 1983) (“in many instances, the evidence in this case consisted of the word of one partner against that of the other”); Saballus v. Timke, 122 Ill. App. 3d 109, 460 N.E.2d 755, 761 (1983) (“it would be difficult to decide which of the parties is most in the wrong”); Nupetco Assocs. v. Jenkins, 669 P.2d 877, 882-83 (Utah 1983) (“Voluminous trial transcript” showed that the partners’ contentions “were widely conflicting and were accompanied by extravagant accusations of breach by the other party.”) Neither party proved by a preponderance of the evidence that the other breached the agreement.); Susman v. Venture, 114 Ill. App. 3d 668, 449 N.E.2d 143, 148 (1982) (trial court heard conflicting evidence as to which party breached the agreement); Lunn v. Kaiser, 76 S.D. 52, 72 N.W.2d 312, 314 (1955) (trial court stated that it was unable to determine whether one partner was more responsible for the discord than the other); Drashner v. Sorenson, 75 S.D. 247, 63 N.W.2d 255, 255-59 (1954) (evidence on fault was sharply in conflict).

267. See supra note 37 and accompanying text. Drashner v. Sorenson, 75 S.D. 247, 63 N.W.2d 255 (1954), provides an illustration of this problem. The dispute between the partners resulted from plaintiff’s dependence upon withdrawing partnership earnings to defray his living expenses, whereas defendants had other sources of support and insisted half the earnings be left in the business. 63 N.W.2d at 258. While there was no finding that defendants were motivated in this instance by a desire to squeeze plaintiff out, limiting distributions from the business is a classic corporate squeeze-out technique. See supra notes 21-23 and accompanying text. Because the partnership was for a term, plaintiff could not protect himself through dissolution at will. Ultimately, he was unable to prove defendants acted wrongfully and hence, he suffered the consequence under section 38(2) of not receiving his interest in the firm’s considerable goodwill. Id. at 259.

partner's death or retirement. Their utility to prevent freeze-outs requires more thought. The problem is the same as with agreeing to a term. If a partner wishes to dissolve the association and yet avoid the buy-sell agreement—thereby hoping to continue the business—he may employ the tactics described above.\textsuperscript{270} Perhaps the agreement could waive the partners' rights to sue for dissolution under section 32. The validity of such a provision is unclear.\textsuperscript{271} It would seem to be a foolish agreement, however, under which an individual has no response to his partner's misconduct or even to irreconcilable differences other than to give up the business. This suggests that for a buy-sell agreement to deal effectively with freeze-outs without spawning significant litigation over fault, it must specifically address the situation in which partners wish to continue the business, but not together, and do so in a way that removes the motivation for either side to avoid the contract. This, in turn, requires fulfilling two criteria. First, the agreement must provide both a fair and efficient means of determining which partner keeps the business. The common language\textsuperscript{272} that talks about the remaining partner's buying out the retiring or withdrawing partner simply begs this question.\textsuperscript{273} Second, it must provide a fair price and terms for the sale.

An often used technique is for one partner to set the price and give the other the option either to buy or sell at that price. In theory, this technique gives the first partner an incentive to set a fair price (knowing that if he sets the price either too high or too low, the other partner will exercise his option accordingly). In practice, this scheme will not work when one partner lacks the funds to make the purchase.\textsuperscript{274} The agreement might be arranged to make provisions for reasonable installment payments. Such a delay in payment, however, may prove overly burdensome to a departing partner looking to enter a new business.\textsuperscript{275} A second alter-

\textsuperscript{270}. E.g., Cooper v. Isaacs, 448 F.2d 1202 (D.C. Cir. 1971) (partner sued for dissolution on grounds of irreconcilable differences in order to avoid impact of buy-sell provision); Fuller v. Brough, 159 Colo. 147, 411 P.2d 18 (1966) (defendant resisted enforcement of non-competition provision on the ground that plaintiff's wrongful conduct justified dissolution of partnership); Steckroth v. Ferguson, 281 Mich. 279, 274 N.W. 792 (1937) (plaintiff sued to dissolve firm for wrongful conduct by defendant; court held buy-sell provision inapplicable).

\textsuperscript{271}. See Cooper v. Isaacs, 448 F.2d 1202, 1206 (D.C. Cir. 1971) (partnership agreement "presumably" can prevent dissolution for irreconcilable differences).

\textsuperscript{272}. See, e.g., M. Volz, C. Trower & D. Reiss, supra note 260, at 224; Bromberg, supra note 44, at 665.

\textsuperscript{273}. See, e.g., Fuller v. Brough, 159 Colo. 147, 411 P.2d 18 (1966) (both partners claimed the other was the withdrawing partner within the meaning of a noncompetition provision).

\textsuperscript{274}. See, e.g., Johnson v. Buck, 540 S.W.2d 393, 410-11 (Tex. Civ. App. 1976) (evidence that one partner set a low price in an offer to buy or sell knowing that the other partner could not afford to purchase).

\textsuperscript{275}. See supra note 214 and accompanying text.
native is to hold a closed auction between the partners.276 Here, the partner who bids the most would buy the other partner's interest. The differences between a closed auction and a liquidation sale are that the auction excludes third parties and the high bidder purchases a partnership interest rather than the firm's assets, thereby achieving potentially more favorable tax treatment.277 Again, there is the possibility of abuse by a partner with a funding advantage. The agreement might counter this possibility of abuse by allowing installment payments. Alternately, the agreement could provide a minimum bid through formula or appraisal.

The prior ideas do not prevent the freeze-outs stemming from one partner's ability to depart with a key intangible asset. For example, a partner who owned the location used by a firm in which location is critical278 could dissolve or be bought out of his interest in partnership assets and still end up with the business.279 Can planning help here? Contract terms that attempt to outline the goodwill the partnership has a claim to and provide methods for its valuation might be useful to minimize and make more predictable litigation over such claims.280 Partners might attempt to go further and prevent appropriation of the firm's goodwill. For example, if one partner owns the location, the other partner could insist upon a long term lease with the right to assign it if the partnership sells the business. An extremely common way to prevent appropriation of goodwill is a covenant not to compete. Courts uphold such agreements so long as they are reasonable.281 Using such agreements, however, may yield undesirable side effects. Covenants not to compete tremendously increase the pressure for partners to seek dissolution under section 32 (or drive the other partner to do so) in order to avoid them.282 Thus, these covenants might well be called covenants to litigate.

277. See supra note 44.
278. E.g., Cude v. Couch, 588 S.W.2d 554 (Tenn. 1979), discussed supra notes 49-53 and accompanying text.
279. Id.
Expulsion Provisions

If partnership agreements can help limit freeze-outs, they can also create new avenues for such tactics. The most obvious way is through a provision allowing expulsion of a partner. The UPA specifically sanctions contracts that give individuals the right to expel their partners from the firm and continue the business without liquidation.\textsuperscript{283} Section 31(1)(d) lists expulsion of a partner "bona fide in accordance with a power conferred by the agreement" as a cause of dissolution that does not violate the partnership contract.\textsuperscript{284} In tandem with this, section 38(1) denies the expelled partner the right to demand liquidation.\textsuperscript{285} Instead, the other partners must obtain the expelled partner's discharge from all the firm's debts. In addition, the remaining partners must pay the expelled partner the net amount he is due from the partnership. Typically, the agreement specifies this amount. If not, section 42 fills the gap.\textsuperscript{286} It grants the expelled partner the right to receive the value on the date of dissolution of his partnership interest plus his choice of interest or profits made by the firm's use of his capital since his removal.\textsuperscript{287}

By definition, an expulsion clause allows the involuntary removal of a partner from the firm. Whether this constitutes a freeze-out in the abusive sense depends upon two factors: First, what grounds the agreement requires for expulsion, and second, what price the continuing partners must pay. Specifying clear and narrow grounds for a partner's removal, especially if limited to some type of objective misconduct,\textsuperscript{288} minimizes the prospects for an abusive freeze-out. Although involuntary, the partner could have prevented removal by avoiding the misdeeds. This works especially well if an outside entity adjudicated the offending act (as in a professional disciplinary proceeding) prior to the expulsion. On the other hand, if there is no such prior adjudication, and especially as the criteria

\textsuperscript{283} UPA § 31(2) (West 1969 & Supp. 1988).
\textsuperscript{284} Id. § 31(1)(d).
\textsuperscript{285} The pertinent part of section 38(1) reads: "But if dissolution is caused by expulsion of a partner, bona fide under the partnership agreement and if the expelled partner is discharged from all partnership liabilities, either by payment or agreement under section 36(2), he shall receive in cash only the net amount due him from the partnership." Id. § 38(1).
\textsuperscript{286} Section 42 applies by its terms, \textit{inter alia}, to partnership businesses continued pursuant to section 41(6). Section 41(6) refers to businesses continued following expulsion of a partner. Id. §§ 41 & 42.
\textsuperscript{287} Id. § 42.
\textsuperscript{288} See, e.g., Bromberg, supra note 44, at 665 (suggested form agreement calling for expulsion, \textit{inter alia}, for professional misconduct or disqualification or for willful or persistent breach of the partnership agreement).
for removal become more vague, the likelihood increases of litigation over whether the applicable grounds in fact existed. Lawsuits might also challenge the procedures followed by the firm in establishing the existence of reasons to expel.

The goal of avoiding this litigation, as well as the desire for greater flexibility, sometimes tempts partners into agreeing to expulsion without the safeguard of meeting objectively determinable criteria. This provision might take any of three forms. Partners may agree upon some vague grounds for expulsion (for example, “the good of the firm”) and leave interpretive discretion entirely with those empowered to expel. Alternately, the agreement may simply name the person or persons having the power to remove a partner and be silent regarding the reasons for removal. Finally, the agreement could expressly allow expulsion “without cause.” In these instances, what protections should courts adopt against abusive freeze-outs?

In the first two situations, courts could interpret the agreement to require that some good cause in fact existed for the expulsion. By and large, however, courts refuse to do so. They point to two justifications for this result. Initially, this interpretation adds to the language of an agreement, which is silent regarding grounds for removal, and seemingly conflicts, at least in part, with language granting certain partners discretion in finding cause. Moreover, this interpretation destroys one perceived purpose of drafting an expulsion clause in this manner, that purpose being to avoid litigation over the existence of cause. Yet, to call such provisions unambiguous displays a rather cramped reading. Stating that a group of

289. See, e.g., id (also allowing expulsion for “conduct which tends to affect prejudicially the carrying on of partnership affairs.”)

290. See, e.g., Millet v. Slocum, 4 A.D.2d 528, 167 N.Y.S.2d 136 (1957) (a partner’s former opposition to a building program and refusal to sign a declaration of intent signed by the other partners did not constitute “incompatibility” within the meaning of an expulsion clause).


294. E.g., Bronberg, supra note 44, at 665.


296. See, e.g., Holman v. Coie, 11 Wash. App. 195, 522 P.2d 515, 523 (1974) (court states that to require notice, and reasonable opportunity to be heard before expulsion when the agreement was silent, “would be to rewrite the agreement of the parties”).


partners may remove another partner when they think it is in the best interest of the firm (or some similar language), merely sets forth a *sine qua non* for expulsion: that is, the partners empowered by the agreement must make the appropriate decision to remove a member of the firm. This type of removal clause does not say that good cause must not have existed. In other words, the language sets out the minimum, not necessarily the entire requirement. Also, it is just as rational to assume the parties intended an implicit requirement of reasonable grounds for removal—rather than subject their interests completely to the whims of other partners—as it is to assume the parties consciously omitted such protection because of a desire to avoid litigation. On balance, given the danger of partners’ abusing expulsion clauses to effect a freeze-out, courts should require agreements be more specific before reading them to dispense with a requirement that there be good cause to expel a partner.

This line of defense is not available if the agreement explicitly states partners may be expelled without cause. Courts might hold such a provision contravenes public policy. This holding seems justified when the parties to the agreement originally were in a grossly unequal bargaining position, especially if the expulsion clause lacks mutuality in its prospective impact on the partners and the set price marked an intended forfeiture of much of the expelled partner’s interest. What should courts do, however, if less than all of these factors are present? Disallowing individuals to agree to expulsion without cause conflicts with the principle that partners ought to be allowed the maximum freedom to work out the terms of their own relationship. Hence, if none of these factors are present,

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299. See Hillman, *supra* note 82, at 568.

300. See Gelder Medical Group v. Webber, 53 A.D.2d 994, 385 N.Y.S.2d 867, 869 (1976), *aff’d*, 41 N.Y.2d 680, 394 N.Y.S.2d 867, 363 N.E.2d 573 (1977), (Mahoney, J., dissenting) (“in the absence of contractual language affirming that intent, it should not be presumed that such men voluntarily elected to hazard their livelihood to the arbitrary whim of their associates”).

301. See, e.g., Shell Oil Co. v. Marinello, 63 N.J. 402, 307 A.2d 596 (1973) (invalidating as against public policy grossly unfair contract terms that tend to injure the public in some way when there is a gross disparity in bargaining power).

302. For an example of such an expulsion clause, see Frank v. R.A. Pickens & Son Co., 264 Ark. 307, 572 S.W.2d 133 (1978) (one partner was empowered to expel any other partner and hence presumably was not subject to expulsion himself).

303. For an example of such an expulsion clause, see McPherson v. J.D. Sirrine & Co., 206 S.C. 183, 33 S.E.2d 501 (1945) (expelled partner under agreement received only one fifth of the amount his estate would have been entitled to under the agreement had he died while a partner).

there seems no support for prohibiting expulsion without cause.\textsuperscript{306} On the other hand, allowing expulsion without cause that results in a forfeiture of the expelled partner's interest (and thus financially advantages the other partners) attempts to permit an action that, as discussed below, individuals cannot undertake in good faith.

This leaves one last protection: the requirement of good faith. As in the case of dissolving a partnership at will, courts have been uncertain regarding the existence and extent of good faith limits upon expulsion. The decision in \textit{Gill v. Mallory}\textsuperscript{306} illustrates this confusion. Plaintiffs sued to enjoin their expulsion from a partnership and appealed the denial of a temporary injunction pending trial.\textsuperscript{307} The partnership agreement permitted those holding a majority of interests in the enterprise to expel a partner if they determined it to be in the best interest of the firm.\textsuperscript{308} Plaintiffs asserted that defendants expelled them "selfishly" and not in good faith.\textsuperscript{309} The court first responded to this contention by stating it was not the purpose of the agreement to allow litigation over such a claim,\textsuperscript{310} thereby suggesting that a challenge to good faith was not available. Later in the opinion, however, the court stated that it did not sufficiently appear that defendants acted in bad faith even "if that were to be the test" to warrant granting a temporary injunction.\textsuperscript{311}

Despite \textit{Gill}, it is reasonably clear that at least some good faith limit exists on expulsions. Unlike the situation with dissolution at will, here the UPA expressly provides this result. Both sections 31(1)(d) and 38(2) speak of "bona fide" expulsions.\textsuperscript{312} One part of the definition of bona fide is in good faith.\textsuperscript{313} In addition, partners have less inherent protection against abuse of an expulsion provision than they do against the consequences of dissolution at will. After dissolution of a partnership at will, all partners can bid for the business in the ensuing liquidation. By contrast, the UPA relegates the expelled partner to whatever price the agree-

\textsuperscript{305} See, e.g., Gelder Medical Group v. Webber, 53 A.D.2d 994, 385 N.Y.S.2d 867 (1976), aff'd, 41 N.Y.2d 680, 363 N.E.2d 573, 394 N.Y.S.2d 867, 870 (1977) (upholding expulsion without cause as long as "no undue penalty or unjust forfeiture, overreaching or other violation of public policy" involved).

\textsuperscript{306} 274 A.D. 84, 80 N.Y.S.2d 155 (1948).

\textsuperscript{307} Id. at 156.

\textsuperscript{308} Id. at 157.

\textsuperscript{309} Id.

\textsuperscript{310} Id.

\textsuperscript{311} Id. at 183-84. In Gelder Medical Group v. Webber, 41 N.Y.2d 680, 363 N.E.2d 573, 394 N.Y.S.2d 867 (1977), the New York Court of Appeals still seemed uncertain as to good faith limits on expulsion. It held that "even if" the limit does exist, it was up to the expelled partner to prove bad faith. 363 N.E.2d at 577, 394 N.Y.S.2d at 870-71.

\textsuperscript{312} See supra note 285 and accompanying text.

\textsuperscript{313} E.g., \textit{BLACK'S LAW DICTIONARY} 160 (5th ed. 1979).
ment provides.\textsuperscript{314}

The critical question, therefore, becomes how to define good faith. This is straightforward when the contract requires some cause to remove a partner. Here, good faith requires two things: First, that the expelling partners in fact believe the required grounds exist, and second, that the specified reason actually motivated their decision.\textsuperscript{315} Indeed, in this context, it is easy to see why the drafters of the UPA used the term “bona fide.” If the contract allows expulsion without cause, however, good faith obviously cannot have this meaning. The earlier discussion of a good faith limit on dissolution at will suggested that the definition of good faith in that context would drift either toward a requirement of good cause to dissolve or else just become a review to ensure the partner buying the assets in liquidation paid a fair price.\textsuperscript{316} A provision allowing expulsion without cause precludes defining good faith to require the existence of good cause. This suggests good faith may really be interpreted as paying a fair price. In fact, some courts have practically reached this result. For example, in \textit{Gill} the court found no sign that defendants acted in bad faith.\textsuperscript{317} The court arrived at this conclusion because plaintiffs received the same amount on their expulsion as they would have received under the agreement in the event of dissolution.\textsuperscript{318} In other words, defendants gained no financial advantage by expelling plaintiffs.\textsuperscript{319} By interpreting the good faith requirement in this manner, courts should avoid abusive freeze-outs resulting in partners being both expelled without a legitimate reason and paid an unfair price for their interest.

\textbf{Agreements Centralizing Authority}

Even without an expulsion clause, partnership contracts may open avenues for effectuating a nominally legal freeze-out. While shareholders’ agreements in closely held corporations often attempt to establish management following the partnership model,\textsuperscript{320} partnership agreements, especially in larger firms, sometimes ape the central management features

\begin{itemize}
\item \textsuperscript{314} UPA § 38(1) (West 1969).
\item \textsuperscript{316} See supra notes 117-22 and accompanying text.
\item \textsuperscript{317} \textit{Gill v. Mallory}, 274 A.D. 84, 80 N.Y.S.2d 155 (1948).
\item \textsuperscript{318} \textit{Id.} at 86, 80 N.Y.S.2d at 158-59.
\item \textsuperscript{319} \textit{See also} Gelder Medical Group v. Webber, 41 N.Y.2d 680, 363 N.E.2d 573, 577, 394 N.Y.S.2d 867, 871 (1977) (no suggestion of “predatory purpose” for expulsion); Holman v. Cole, 11 Wash. App. 195, 522 P.2d 515, 523 (1974) (“there is no evidence the purpose of the severance was to gain any business or property advantage to the remaining partners”).
\item \textsuperscript{320} \textit{Cf.} Del. Code Ann. tit. 8 § 354 (1988) (validating agreements by shareholders of close corporations to manage the company as if it were a partnership).
\end{itemize}
of a corporation. By doing so, the partnership agreements may make available some of the subtle freeze-out techniques employed in the corporate setting.

One possibility occurs if the agreement abrogates the requirement of unanimous consent in order to convey all the firm's assets. In that situation, the majority or managing partners could attempt to sell the entire business to a firm owned by themselves which excludes partners they wish to freeze-out. Unless the agreement specifically authorizes this transaction—in contrast, for example, to containing one clause granting a majority of partners the power to sell all the assets and even a separate clause allowing them to buy assets from the firm—courts should hold such a purchase to be a per se breach of the partners' fiduciary duty. There is simply no legitimate reason for this transaction. If the minority or nonmanaging partners somehow obstruct the firm's operation, dissolution is an available remedy. Indeed, if the obstruction is wrongful, the majority or managing partners may continue the firm without liquidation. It is extremely unlikely that an agreement will specifically authorize the majority or managing partners to sell all the assets to themselves and exclude some partners from the continuing business. If this type agreement ever occurs, the effect is to reduce the court to scrutinizing the sale for fairness based on price.

Another possibility is an agreement that gives some partners the power to undertake the sort of squeeze-outs common in closely held corpora-

322. See, e.g., M. Volz, C. Trower & D. Reiss, supra note 260, at 135 (form agreement giving general partner power to sell all assets without consent of limited partners).
323. Cf. Flint v. Codman, 247 Mass. 463, 142 N.E. 256 (1924) (trustees of business trust sold the firm's real estate to a corporation owned by themselves which excluded minority shareholders).
324. See supra note 323.
325. Cf. M. Volz, C. Trower & D. Reiss, supra note 260, at 136-37 (form agreement providing that the validity of any transactions between the general partner and the firm will be unaffected by this relationship).
326. See Soderstrom v. Kungsholm Baking Co., 189 F.2d 1008 (7th Cir. 1951); Flint v. Codman, 247 Mass. 463, 142 N.E. 256 (1924). Cf. Hooper v. Yoder, 737 P.2d 852 (Colo. 1987) (a partner breached his fiduciary duty in causing a corporation that both partners had agreed to form in order to take over the partnership business to issue shares to himself but not to his partner); Morris v. Zuckerman, 69 Cal. 2d 686, 446 P.2d 1000, 72 Cal. Rptr. 880 (1968) (a partner breached his fiduciary duty in purchasing the firm's property in a sale resulting from the firm's default on a contract to the exclusion of his partner).
327. See supra note 55.
328. See supra note 56 and accompanying text.
329. Cf. Rivera Congress Assocs. v. Yassky, 18 N.Y.2d 540, 223 N.E.2d 876, 880, 277 N.Y.S.2d 386, 392 (1966) ("However, partners may include in the partnership articles practically 'any agreement they wish' and, if the asserted self-dealing was actually contemplated and authorized, it would not, ipso facto, be impermissible and deemed wrongful.").
Partnership Freeze-Outs

McCallum v. Asbury provides an illustration. This lawsuit involved a medical partnership whose governing contract stated that a majority of partners could amend it. Differences between plaintiff and his partners led a majority of the firm to amend the contract to create an executive committee. The amendment empowered the committee to manage generally all affairs of the partnership. Plaintiff was not a member of this committee. While all partners could attend its meetings, nonmembers could not participate in deliberations unless given permission. The effect, of course, was to squeeze plaintiff out of participation in management by ensuring he was seen but not heard. While defendants did not attempt to do so (and, indeed, their specific agreement should have precluded such an action) it would not be beyond the realm of possibility to conceive of a majority's amending a contract pursuant to this type of clause to provide salaries, restrict withdrawals, and thus complete a classic closely held corporation squeeze-out.

Of course, the best defense against these tactics is for prospective partners to refuse to agree to contracts providing a majority or managing partner with a blank check. The question remains, however, what protections should courts accord to those who do enter such agreements? The Oregon Supreme Court in McCallum provided one idea. It stated that the majority could not make fundamental changes in the partnership agreement despite the provision allowing amendments. Hence, the court examined the powers delegated to the executive committee and upheld the amendment only after noting that the partners as a whole could veto any committee action. The court also noted that plaintiff had already expressed his views and the committee was no more likely to ignore his views than the partners as a whole already had. Whatever one thinks of the court's idea, it stands on questionable authority. The court relied upon section 18(h) of the UPA, which provides that a majority vote of the partners governs ordinary matters but actions in contravention of the partnership agreement require unanimous consent. Section 18(h), like

330. See supra notes 21-23 and accompanying text.
331. 238 Or. 257, 393 P.2d 774 (1964).
332. 393 P.2d at 774, 775.
333. Id.
334. Id.
335. Id. at 776.
336. Id.
337. The agreement stated that any amendment “shall not be discriminating against any partner orpartners.” Id. at 775.
338. Id.
339. Id. at 776.
340. Id.
341. Id. at 775.
all of section 18, however, is expressly subject to contrary agreement by the partners.\textsuperscript{342} Despite its loose reasoning, this approach at least provides a constraint on freeze-outs. There should be little question that completely squeezing a partner out of both management and income qualifies as a "fundamental" change in the partnership agreement.\textsuperscript{343}

If other courts do not follow McCallum's rather imaginative reading of the UPA, the only protection left is to turn toward concepts of good faith and fiduciary duty. There is no dispute that managing partners owe an especially exacting level of fiduciary obligation toward their fellow partners.\textsuperscript{344} Therefore, courts will subject any dealings by managing partners favoring themselves at the expense of their fellow partners to close, and often damning, scrutiny.\textsuperscript{345} This should be sufficient to preclude squeezes that completely render a partner's interest worthless.\textsuperscript{346} Less extreme actions, as in McCallum, however, might often survive review.\textsuperscript{347} This is especially so if the majority or managing partners can point to some degree of fault upon the complaining partner.\textsuperscript{348} The final irony is that just as the concept of fiduciary duty may provide the last refuge for shareholders in closely held corporations who have done too little planning,\textsuperscript{349} it may become the last shelter for partners who have done too

\textsuperscript{342} UPA § 18 (West 1969 & Supp. 1988) states in pertinent part:

The rights and duties of the partners in relation to the partnership shall be determined, subject to any agreement between them, by the following rules:

\textsuperscript{(h)} Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners; but no act in contravention of any agreement between the partners may be done rightfully without the consent of all the partners.

\textsuperscript{343} Cf. \textit{In re Topper}, 107 Misc. 2d 25, 433 N.Y.S.2d 359 (1980) (majority shareholders of a closely held corporation were guilty of oppression toward a minority shareholder when they discharged him as an officer of the corporation contrary to the original expectations of the parties to the venture).


\textsuperscript{346} Cf. Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, 353 N.E.2d 657 (1976) (majority shareholders breached their fiduciary duty by squeezing minority shareholder out of employment with the corporation; court drew an analogy to the fiduciary duty of partners toward each other).


IV. Conclusion

It really should not surprise anyone that the problem of preventing partnership freeze-outs refuses to yield to a simple, elegant solution. After all, dissolution of a partnership, like the break-up of other relationships, is often going to be a messy affair. What emerges instead through the entire problem is a constant tension between two goals. First, there is the need to prevent partners from exploiting an advantage to freeze-out their fellow partners. At the same time, however, one would hope to avoid partnership dissolution turning into the business equivalent of "Divorce Court" in which each partner recounts every trivial incident in an attempt to blame the other for the separation. Perhaps courts and those drafting partnership contracts can achieve the best balance between these objectives by generally focusing their attention on achieving a fair price.