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Expelling Law Firm Partners

Douglas R. Richmond
Global Professional Practice, Aon Risk Services

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EXPELLING LAW FIRM PARTNERS

DOUGLAS R. RICHMOND*

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I. INTRODUCTION

Law firms have historically been organized as partnerships. For many years, the traditional law partnership model assumed that partners would remain partners until their retirement or untimely death; their firms were faithful to them over their career course.[1] If partnership was not equivalent to academic tenure, it was fairly close. Such security is no longer the rule. For lawyers practicing in large law firms, remaining a partner has joined becoming a partner as a career aspiration.[2]

In 2007, the AmLaw 100—the nation's top-grossing law firms—completed a five-year economic surge so prosperous that it was touted by the legal media as the "Law Firm Golden Age."[3] Yet in this time of incredible bounty, thirty-seven of the nation's richest law firms reduced their equity partnerships.[4] In some cases they expelled partners outright and in others they "de-equitized" them. "De-equitization," of course, refers to the demotion of partners from equity status, where they share in firm profits, to non-equity status, where they do not share in profits and are instead compensated via guaranteed payments out of firm profits that resemble a salary.[5]

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*Senior Vice President, Global Profession Practice, Aon Risk Services, Chicago, Illinois. J.D., University of Kansas; M.Ed., University of Nebraska; B.S., Fort Hays State University. Opinions expressed here are the author's alone.

[1]Geoffrey C. Hazard, Jr., *The Underlying Causes of Withdrawal and Expulsion of Partners from Law Firms*, 55 WASH. & LEE L. REV. 1073, 1073 (1998).

[2]Nathan Koppel, *Partnership Is No Longer a Tenured Position – More Law Firms Thin Ranks of Partners to Boost Profits, Attract, Keep High Earners*. WALL ST. J., July 6, 2007, at B1.

[3]Aric Press & John O'Connor, *Lessons of the* Am Law 100, AM. LAW., May 2008, at 131.

[4]*Id.*

[5]Generally speaking, firms also return to de-equitized partners any capital they contributed to the firm in connection with their equity partnership.

Consider, for example, Chicago's venerable Mayer Brown, which reported 2007 profits per partner of $1.24 million, up from $1.12 million in 2006.[6] In early 2007, Mayer Brown either expelled outright or de-equitized forty-five partners as a result of its leaders' concern that its profits per partner compared unfavorably to those of its competitors. "We want to drive our stock price up," the firm's incoming chairman was quoted as saying about the action.[7] Although such remarks may seem callous, they are consistent with current law firm management principles. Numerous other large law firms have also thinned their equity partnership ranks recently, whether driven by a desire to increase their profits per partner or because some areas of their practices have materially slowed.[8] Many of these firms appear to outside observers to be financially robust.

While expulsion plainly is an important remedy for law firms hampered by shirking or untrustworthy partners, today many expelled partners do not obviously fit into either of these categories. Increasingly, former partners allege that their expulsions were the product not of their poor performance or their firms' economic plight, but instead were fueled by their firms' corrupt or immoral aspirations or purposes.[9] Expulsion decisions that law firms characterize as valid business judgments are in some affected partners' eyes naked economic predation. The problem is not their under-performance, expelled partners commonly assert, but former colleagues' avarice and narcissism, and law firm leaders' desire to hoard wealth and financially benefit favored colleagues. To some observers, such

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[6] *More Firms Enter Seven-Figure Territory*, AM. LAW., May 2008, at 195, 195 (calculating 2006 profits per partner from 2007 figure and reported percentage growth).

[7] Posting of Ashby Jones to The Wall Street Journal Law Blog, http://blogs.wsj.com/law/2007/03/02/move-on-the-mayer-brown-departures/ (Mar. 2, 2007) (quoting James Holzhauer).

[8] *See, e.g.*, *Citing a Soft Economy, Sonnenschein Cuts 37*, 30 NAT'L L.J. 3, 3 (2008) (reporting that a large law firm expelled six partners as a result of its slowing real estate and financial practices); Ameet Sachdev, *Jenner & Block Law Firm Cuts Several Partners*, CHI. TRIB., Mar. 6, 2008, Business, at C1 (reporting on second round of partner de-equitizations and expulsions at firm); Koppel, *supra* note 2, at B1 (describing increasingly frequent partner de-equitization, expulsion and "decompression" as firms attempt to increase profitability); Lynne Marek, *Jenner & Block Takes Some Partners Off Equity Level*, 29 NAT'L L.J. 10, 10 (2007) (reporting on law firm de-equitizing some partners and asking others to leave); Elizabeth Goldberg, *The Departed*, AM. LAW., May 2007, at 145 (identifying several large law firms orchestrating exits of allegedly under-performing partners); Leigh Jones, *Downsizing: Who's Next? After Mayer, Parring Partners to up Profits*, 29 NAT'L L.J. 1, 1 (2007) (discussing firms downsizing equity partner ranks); Anthony Lin, *Some Partners Will get the Ax at Chadbourne*, 28 NAT'L L.J. 10, 10 (2006) (reporting firm's intention to expel some partners given disappointing financial results).

[9] *See, e.g.*, Lynne Marek, *Former Mayer Brown Partner Sues Over Ousting*, 30 NAT'L L.J. 10, 10 (2008) (reporting former partner's allegation that firm expelled him in an effort to inappropriately pursue new business); Brenda Sandburg, *Dewey Fight Continues*, 29 LEGAL TIMES 10, 15 (2006) (reporting on expelled partner's suit against his former law firm); Anthony Lin, *Dismissed Partner Sues Holland & Knight for Fraud, Age Bias*, 236 N.Y. L.J. 1, 1 (2006) (discussing expelled partner's lawsuit against his former firm).

rapacious behavior is amply evidenced by firms' expulsion and de-equitization of competent and honest partners during profitable periods.[10]

Law firms contemplating partner expulsions must appreciate the potential for claims of bad faith or other misconduct linked to their actions.[11] Unlike terminating employees—which in most cases is straightforward—expelling partners can be "a difficult, tricky, and potentially dangerous exercise."[12] There is the language of the partnership agreement to contend with and, beyond that, the partnership relation "is a fiduciary one, a relation of trust" that carries with it "the requirement of utmost good faith and loyalty."[13] Indeed, of all possible business relationships, partnership clearly requires of its parties the highest degree of good faith.[14] At the same time, there are few reported cases on law firm partner expulsions. As a practical matter, partners who believe they were wrongfully expelled may nonetheless opt not to sue their former law firms for fear that doing so will diminish their ability to secure a position at another firm, impair their ability to recoup their capital from their former firms, harm their reputations, or ruin key relationships. Lawyers who are wise in the ways of litigation may consider it undesirable to sue their former partners because of the associated time or expense. Firms may offer attractive severance packages to partners who agree to resign in lieu of expulsion, or who agree not to challenge their expulsions. Many firms include arbitration provisions in their partnership agreements, meaning that expulsion disputes are resolved privately.

Some scholars suggest that judicial regulation of law firm partnership expulsions is generally unwise or unnecessary because law firms have strong incentives to avoid abusing their expulsion power. For example, Professor Larry Ribstein posits that the threat of misguided expulsion "may deter partners from contributing to their firm's reputation rather than their own."[15] If partners fear expulsion and thus the appropriation of their rights in their firm's reputation, they "will be deterred from contributing to the development of the firm's reputation. They will instead focus on their own clients as a kind of job insurance. Thus, abusive expulsion[s] may discourage actions that help the firm."[16] As another basis for urging judicial restraint in this context, he asserts that firms that expel productive partners incur reputational costs.[17] Such firms "send signals not only to other lawyers in the firm, but also to

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[10] *See, e.g.*, Goldberg, *supra* note 8, at 149 (quoting a harshly critical observer of Mayer Brown's actions).

[11] *See* Paula J. Dalley, *The Law of Partner Expulsions: Fiduciary Duty and Good Faith*, 21 CARDOZO L. REV. 181, 182 (1999) ("Expelled partners generally argue that their expulsions constitute a breach of fiduciary duty and of good faith.").

[12] Robert W. Hillman, *The Impact of Partnership Law on the Legal Profession*, 67 FORDHAM L. REV. 393, 396 (1998).

[13] Della Ratta v. Larkin, 856 A.2d 643, 658 (Md. 2004).

[14] *See* Lach v. Man O'War, L.L.C., 256 S.W.3d 563, 569 (Ky. 2008) (citing Van Hooser v. Keenon, 271 S.W.2d 270, 273 (Ky. 1954)).

[15] Larry E. Ribstein, *Law Partner Expulsion*, 55 BUS. LAW. 845, 851 (2000).

[16] *Id.* (footnote omitted).

[17] *Id.* at 852.

potential future hires, to be wary of dealing with the firm."[18] Finally, Professor Ribstein reasons, it is unlikely that courts will do a better job than firms themselves of determining whether expulsions were justified.[19] In summary, he contends, "placing judicial constraints on the expulsion power weakens the effectiveness of this remedy."[20]

In fact, nothing about the threat of misguided expulsion induces partners to put their interests first. Many partners will do that anyway. "Much current practice in [law] firm governance, organization, and (not least) compensation comes from the fact that partners vigorously defend their rights to autonomy and individualism, well beyond what is common in other professions."[21] Partners focus on their clients because of the associated psychic benefits, because firm compensation systems reward business development, and because controlling business provides opportunity and security beyond warding off expulsion. As for the risk of reputational injury, most lawyers think *they* will never be expelled, meaning that they may not be skeptical of firms that prune partners. In addition, expulsions may perversely enhance firms' reputations. Some firms promote their "tough-minded approach" to handling unproductive partners.[22] "There is much less of a stigma attached to [expelling partners] than even five years ago. . . . More and more, firms realize you need to send a message to the market that you are a hard-working firm."[23] The key question is whether lawyers are capable of distinguishing wrongful expulsions at other firms. If not, firms have little or no associated reputational risk. Finally, as to courts' questionable competence to adjudicate expulsion disputes, the same observation can be made with respect to many employment disputes and countless other controversies that pivot on indirect evidence and parties' subjective determinations. Yet courts capably resolve such disputes every day. For that matter, objective observers should be skeptical of the notion that self-interested law firms are best positioned to weigh the propriety of their allegedly wrongful expulsions.

In any event, in the current law firm climate, it is important to understand the rules governing partner expulsion. Indeed, as law firm productivity slowed in the first half of 2008, legal industry consultants began touting as "a silver lining" the fact that a "bad year" (relatively speaking) would enable firms to take steps that their partners would usually resist, such as "winnowing out unproductive lawyers."[24] These consultants clearly envision increasing numbers of law firms shedding both equity and non-equity partners to stabilize or enhance profitability.

This article will examine the contours of firms' expulsion power, beginning in Part II with a brief discussion of relevant partnership law. Part III examines the leading law firm partner expulsion cases and principles distilled from them. Part IV addresses two current issues that have so far escaped analysis. First, it considers

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[18] *Id.*

[19] *Id.*

[20] Ribstein, *supra* note 15, at 852.

[21] David Maister, *The Trouble With Lawyers*, AM. LAW., Apr. 2006, at 97, 98.

[22] Koppel, *supra* note 2, at B1 (citing law firm consultant Peter Zeughauser).

[23] *Id.* (quoting law firm consultant Peter Zeughauser).

[24] Dan DiPietro, *Under Pressure*, AM. LAW., Oct. 2008, at 79.

whether partner de-equitization constitutes expulsion. Second, it highlights concerns where firms rest expulsion power in a single decision-maker, such as a managing partner or chairperson. Finally, Part V examines employment law constraints on law firms' ability to expel or de-equitize partners in light of the Seventh Circuit's decision in *EEOC v. Sidley Austin Brown & Wood*.[25]

II. PARTNERSHIP LAW FUNDAMENTALS

Partnership law is in many respects statutory, but somewhat less so insofar as partner expulsion is concerned. The Uniform Partnership Act ("UPA"), long the underpinning for state partnership laws, provides only that expulsion provisions in partnership agreements are to be given effect.[26] Of course, partners may generally fix their rights by agreement.[27] The subsequent Revised Uniform Partnership Act ("RUPA"), which adopts the entity theory of partnership, perpetuates that scheme while broadening it somewhat.[28] RUPA permits the expulsion of a partner by a unanimous vote of the other partners in some circumstances, even if the partnership agreement does not authorize expulsion.[29] Furthermore, under RUPA, a partnership may petition a court to expel a partner for specified misconduct regardless of whether the partnership agreement provides for expulsion.[30]

Thus, in states adhering to the UPA or a variation thereof, a firm's right to expel a partner "arises, if at all, from the partnership agreement."[31] Absent an expulsion provision in the partnership agreement, the UPA effectively provides that a firm can rid itself of a partner only through a dissolution and later reformation without the partner proposed to be ousted.[32] Attempting to expel a partner in the absence of an expulsion clause is a breach of the partnership agreement that entitles the partner to

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[25] 315 F.3d 696 (7th Cir. 2002).

[26] UNIF. P'SHIP ACT § 31(1)(d) (1914) (recognizing expulsion "from the business bona fide in accordance with such a power conferred by the agreement between the partners").

[27] Bailey v. Fish & Neave, 868 N.E.2d 956, 959 (N.Y. 2007).

[28] ROBERT W. HILLMAN ET AL., THE REVISED UNIFORM PARTNERSHIP ACT § 601(3) (2007) (perpetuating the UPA scheme by recognizing a partner's dissociation from a firm upon "the partner's expulsion pursuant to the partnership agreement").

[29] § 601(4) (permitting expulsion by unanimous vote absent an expulsion clause where it would be unlawful to carry on business with the subject partner, there has been a qualifying transfer of the partner's transferable interest in the partnership, the subject partner is a corporation that is dissolving or intends to dissolve, or a partnership is a partner that is dissolved and is winding up).

[30] § 601(5) (allowing expulsion by judicial determination where subject partner engaged in wrongful conduct adversely and materially affecting the partnership's business, partner persistently or willfully committed a material breach of the partnership agreement or of certain other duties owed to the other partners or to the partnership, or partner's conduct relating to the partnership business is such that it is not reasonably practicable to carry on the partnership business with him).

[31] Allan W. Vestal, *Law Partner Expulsions*, 55 WASH. & LEE L. REV. 1083, 1111 (1998); *accord* Jeff Schwartz, *Good Faith in Partner Expulsions: Application of a Contract Law Paradigm*, 9 CHAP. L. REV. 1, 1 (2005) (making the same point).

[32] Dawson v. White & Case, 672 N.E.2d 589, 592 (N.Y. 1996).

damages.[33] Even in states that have adopted RUPA, partnerships may neatly expel a partner only if they provide for expulsion in their agreement. The circumstances in which a firm can expel a partner by unanimous partnership vote are narrow and rare, and unanimity may be difficult to achieve. Seeking a judicial expulsion is potentially aggravating, costly, and time-consuming. Suing to expel a partner is also likely to generate adverse publicity for a firm. Accordingly, most partnership agreements today contain expulsion provisions.

There certainly are situations in which firms are legitimately interested in removing partners. Because these situations vary widely, are usually fact-specific, and firms must sometimes act expediently to remove disruptive or irresponsible partners, most law firm partnership agreements are drafted very broadly. They typically permit expulsion without cause and do not provide due process protections or afford the target partner an opportunity to be heard.[34] For example, a partnership agreement might provide:

> The Partnership shall have the right at any time to cause the removal of any partner, upon making the determination that the partner is unable for any reason to continue as a member of the Partnership in a proper manner, or that, for any reason, such partner's continued membership in the Partnership is inappropriate. Such determination shall require the affirmative vote of 3/4 of all of the partners then constituting the Partnership. If such determination shall be made as aforesaid, the removal of such partner from the Partnership shall become effective immediately upon the date of such affirmative vote.[35]

The expulsion of a partner without cause or an opportunity to be heard is commonly referred to as the "guillotine approach"[36] or as a "guillotine severance."[37]

The interpretation of a partnership agreement is a question of law.[38] Courts strictly construe expulsion clauses, as *Ehrlich v. Howe*[39] illustrates. The plaintiff in *Ehrlich* was a partner in a New York law firm. Although he was a partner, Ehrlich's

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[33] Dalley, *supra* note 11, at 185.

[34] If an expulsion provision in a partnership agreement is silent as to cause, a court will not read a cause requirement into it. If the provision includes a cause requirement, a court will strictly enforce it. Vestal, *supra* note 31, at 1111-12. Courts will not read a due process requirement into an expulsion provision where it does not otherwise exist. *See, e.g.*, Waite *ex rel.* Bretton Woods Acquisition Co. v. Sylvester, 560 A.2d 619, 622-23 (N.H. 1989); Leigh v. Crescent Square, Ltd., 608 N.E.2d 1166, 1168 (Ohio Ct. App. 1992); Holman v. Coie, 522 P.2d 515, 524 (Wash. Ct. App. 1974).

[35] Confidentiality obligations require that the firm from whose partnership agreement this clause is lifted not be identified.

[36] Heller v. Pillsbury Madison & Sutro, 58 Cal. Rptr. 2d 336, 347 (Ct. App. 1996) (quoting *Holman*, 522 P.2d at 523-24).

[37] Lawlis v. Kightlinger & Gray, 562 N.E.2d 435, 443 (Ind. Ct. App. 1990).

[38] Nationwide Mortgage Servs., Inc. v. Troy Langley Constr. Co., 634 S.E.2d 502, 507 (Ga. Ct. App. 2006); Shoemaker v. Shoemaker, 745 N.W.2d 299, 308 (Neb. 2008); *In re* Dissolution of Midnight Star Enters., L.P., 724 N.W.2d 334, 336 (S.D. 2006).

[39] 848 F. Supp. 482 (S.D.N.Y. 1994).

equity interest in the firm did not vest until his third anniversary as a partner. The other partners voted to expel Ehrlich nine months before his third anniversary.[40] The firm did not inform him of the meeting at which the vote to expel was taken, and thus, he was not present at the meeting.[41] Ehrlich claimed that he was expelled to prevent him from acquiring an equity interest in the firm.[42] Ehrlich sued the firm and his former partners on several theories, and the parties ultimately filed cross-motions for summary judgment.

Ehrlich alleged that his expulsion breached the firm's partnership agreement and violated his co-partners' fiduciary duties.[43] These allegations rested on the defendants' decision to exclude him from the secret meeting at which the expulsion vote was taken.[44] As the court noted, "all partnership agreements in New York include 'an implied term of good faith.'"[45] In the partnership context, "this duty rises to one of 'finest loyalty' and 'honor most sensitive.'"[46] Partners' fiduciary duties to one another are defined by their agreement.[47] With those principles in mind, the court turned to the parties' agreement.

With respect to voting on firm decisions, the firm's partnership agreement provided:

> Every partner shall have one partnership vote for each unit of participation held by him. . . .
>
> A partner shall not vote, however, and the number of partnership votes shall be deemed reduced by the number of partnership votes appertaining to such partner:
>
> * * *
>
> (b) if the issue before the partnership is whether such partner . . . should be expelled.[48]

As for expulsion, the agreement provided that any partner, other than the senior partner (which Ehrlich was not), could be expelled upon the affirmative vote of all other partners.[49] Finally, the agreement defined "partner" to include all partners whose membership in the firm had not been terminated.[50]

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[40] *Id.* at 485.

[41] *Id.*

[42] *Id.*

[43] *Id.* at 490.

[44] *Id.*

[45] *Id.* at 491 (quoting Gelder Med. Group v. Webber, 363 N.E.2d 573, 577 (N.Y. 1977)).

[46] *Id.* (quoting Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928)).

[47] *Id.* at 491.

[48] *Id.*

[49] *Ehrlich*, 848 F. Supp. at 491.

[50] *Id.*

The court read the voting and expulsion provisions of the partnership agreement to require that the expulsion of a partner "be 'before the partnership,' i.e., before all the partners."[51] For an expulsion vote to be before the partnership, all partners, including any partners whose expulsion is being considered, had to be notified of the vote.[52] This was a critically important right because a partner facing expulsion needed to sway only one colleague to retain his position.[53]

The defendants countered that the partnership agreement did not require a meeting to vote to expel a partner, which could be accomplished by circulating a memorandum.[54] The court noted, however, that even if this assertion were true, the issue of Ehrlich's expulsion would still have to be brought "before" the partnership, and Ehrlich would still be entitled to notice that the vote was taking place.[55]

The *Ehrlich* court concluded that it should not re-write an unambiguous partnership agreement.[56] Because Ehrlich's expulsion was not "before the partnership," the defendants' vote to expel him breached the agreement and their fiduciary duties.[57] The court therefore granted Ehrlich summary judgment on this issue.[58]

The decision in *Ehrlich* does more than just illustrate courts' strict construction of expulsion clauses in partnership agreements; it points to the critical issue in most expulsion controversies—that is, whether the decision to expel was made in bad faith. Even where a partnership agreement contains a clear expulsion provision, the firm's decision to expel a partner must be made in good faith.[59] Partners cannot in their partnership agreement contract away their obligation of good faith.[60]

Clearly, a firm and its remaining partners owe a partner they intend to expel a duty of good faith and fair dealing. The source of that duty, however, is unclear.[61] The duty must arise either from the partnership agreement or out of partners' fiduciary duties to one another. Rooting the duty in the partnership agreement is logical, given that partnership agreements are contracts and the law implies a duty of

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[51] *Id.*

[52] *Id.*

[53] *Id.*

[54] *Ehrlich*, 848 F. Supp. at 491.

[55] *Id.* (internal quotation marks omitted).

[56] *Id.* (citing Silverman v. Caplin, 541 N.Y.S.2d 546, 546 (N.Y. App. Div. 1989)).

[57] *Id.* at 492.

[58] *Id.*

[59] Vestal, *supra* note 31, at 1112; Schwartz, *supra* note 31, at 1.

[60] Winston & Strawn v. Nosal, 664 N.E.2d 239, 243 (Ill. App. Ct. 1996) (involving partnership act premised on UPA, although decision does not refer to statutes in deciding good faith issue); Alloy v. Wills Family Trust, 944 A.2d 1234, 1249-50 (Md. Ct. Spec. App. 2008) (interpreting District of Columbia law and noting that partners cannot contractually waive their duty of good faith); ROBERT W. HILLMAN ET AL., THE REVISED UNIFORM PARTNERSHIP ACT § 103(b)(5) (2007).

[61] Schwartz, *supra* note 31, at 3.

good faith and fair dealing in every contract.[62] Traditionally, however, courts have conceptualized the duty of good faith in intra-partner affairs as a form of the fiduciary duty of loyalty,[63] or as a close or overlapping relative thereof.[64] Courts' tendency to treat co-partners' duty of good faith as a type or subcategory of fiduciary duty continues today.[65] Many courts, however, are uncertain about differences between contractual good faith and fiduciary duties.[66]

It is perhaps easiest to frame co-partners' reciprocal duty of good faith as a fiduciary duty rather than a contractual obligation. This is because some partnership agreements provide that a firm may expel a partner for any reason, and contract law generally holds that there can be no breach of the duty of good faith where the subject contract expressly permits the challenged action and the defendant acts in accordance with the contract.[67] Thus, it might be argued that expelling a partner pursuant to a provision clause permitting expulsion for any reason cannot be a breach of the duty of good faith. There should be considerable doubt about the viability of this argument in any event,[68] but making the duty of good faith a fiduciary duty

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[62]RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981); *see, e.g.*, Wilensky v. Blalock, 414 S.E.2d 1, 4 (Ga. 1992) (finding implied duty of good faith in oral partnership agreement); Phelps v. Frampton, 170 P.3d 474, 483 (Mont. 2007) (implying duty of good faith and fair dealing in partnership agreement).

[63]Schwartz, *supra* note 31, at 3; *see, e.g.*, Winston & Strawn, 664 N.E.2d at 245-46; *Alloy*, 944 A.2d at 1250; Leigh v. Crescent Square, Ltd., 608 N.E.2d 1166, 1169-71 (Ohio Ct. App. 1992).

[64]*See, e.g.*, *Phelps*, 170 P.3d at 482 (stating that partners "have an obligation of good faith and fair dealing in the discharge of their fiduciary duties of loyalty and care"); Moore v. Moore, 599 S.E.2d 467, 472 (S.C. Ct. App. 2004) ("Partners are fiduciaries to each other and their relationship is one of mutual trust and confidence, imposing upon them requirements of loyalty, good faith and fair dealing.").

[65]*See, e.g.*, Poeta v. Jaffe, No. 1357, 2001 WL 1773885, at *2 (Pa. Ct. C.P. Oct. 2, 2001) (observing that partners "owe each other a fiduciary duty to act in good faith during the life of the partnership").

[66]Dalley, *supra* note 11, at 183.

[67]Corporate Fin., Inc. v. Principal Life Ins. Co., 461 F. Supp. 2d 1274, 1288 (S.D. Fla. 2006) (citing Snow v. Ruden, McClosky, Smith, Schuster & Russell, P.A., 896 So. 2d 787, 791 (Fla. Dist. Ct. App. 2005)); Bishop v. Shelter Mut. Ins. Co., 129 S.W.3d 500, 505 (Mo. Ct. App. 2004) (quoting 23 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 63:22, at 516 (Jack K. Levin et al. eds, 4th ed. 2002)); *see also* Sanders v. FedEx Ground Package Sys., Inc., 188 P.3d 1200, 1203 (N.M. 2008) ("[T]he implied covenant of good faith and fair dealing cannot be used to overcome or negate an express term contained within a contract.").

[68]*Winston & Strawn*, 664 N.E.2d at 246 (conferring broad discretion on partners in partnership agreement does not abrogate duty of good faith and fair dealing); ROBERT W. HILLMAN ET AL., THE REVISED UNIFORM PARTNERSHIP ACT § 103(b)(5) (2007 ed.) (prohibiting partners from eliminating the duty of good faith and fair dealing in their partnership agreement).

rather than a contractual obligation avoids it altogether.[69] Partners who are expelled for predatory reasons, for example, should not be forced to endure the associated hardship and loss on the basis that they agreed to such savagery.[70] To be sure, in contract law as elsewhere, general rules include a variety of exceptions, and different jurisdictions have long taken different approaches to the duty of good faith and fair dealing in the employment realm.[71] Characterizing the duty as a fiduciary obligation, however, avoids some theoretical impediments to its enforcement.[72]

Whether the duty of good faith in partner expulsions is a contract-based doctrine or is appropriately categorized as a type of fiduciary obligation has generated wide scholarly debate. The importance of that debate is arguably questionable given courts' recognition of the duty of good faith and fair dealing regardless of its foundation. What has escaped much attention, however, is RUPA's role in expulsion controversies. Section 404 of RUPA provides in pertinent part:

> (a) The only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care set forth in subsections (b) and (c).

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[69] *See Winston & Strawn*, 664 N.E.2d at 246 ("Regardless of the discretion conferred upon partners under a partnership agreement, this does not abrogate their high duty to exercise good faith and fair dealing in the execution of such discretion.").

[70] While the original partners who forge an agreement might think they should be able to consent to expulsion for literally any reason, including economically predatory ones, such an agreement would be bad public policy. Furthermore, consider new partners who are invited to join the partnership well after the partnership agreement is struck, as is the case in large law firms. A new partner joining a large law firm has no real ability to suggest that the firm modify its expulsion clause. New partners invited to join a large law firm are presented the opportunity on a take-it-or-leave-it basis. For them, partnership agreements are adhesion contracts.

[71] *See, e.g.*, Fortune v. Nat'l Cash Register Co., 364 N.E.2d 1251, 1255-57 (Mass. 1977) (implying duty of good faith and fair dealing in employment contract that was expressly terminable at will without cause or written notice).

[72] Some scholars might disagree with this assertion on the basis that fiduciary duties in business associations should be regarded as default rules that "can be displaced by explicit provisions of the contract." Larry E. Ribstein, *Fiduciary Duties and Limited Partnership Agreements*, 37 SUFFOLK U. L. REV. 927, 965 (2004). This is not true with respect to the duty of good faith and fair dealing, of course. *See* sources cited *supra* note 60 and accompanying text. Other scholars observe that if good faith and fair dealing is a fiduciary duty that can be contracted away in some business relationships, then it may have to be recognized in contractual form to regulate ostensibly permissible discretionary decisions that defeat the parties' reasonable expectations. *See* Andrew S. Gold, *On the Elimination of Fiduciary Duties: A Theory of Good Faith for Unincorporated Firms*, 41 WAKE FOREST L. REV. 123, 174 (2006) (giving example of manager contractually granted absolute discretion in transactions involving self-dealing violating duty of good faith and fair dealing by misappropriating assets or engaging in fraud on the basis that the parties could never have contemplated such an exercise of discretion). In the end, common sense demands recognition of the duty of good faith and fair dealing on *some* basis to prevent or remedy economic predation by partners in the guise of contractually permissible conduct. It is not the law that "anything goes" in partnership relations so long as the partners have a contract.

(b) A partner's duty of loyalty to the partnership and the other partners is limited to the following:

(1) to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity;

(2) to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and

(3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.

(c) A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership['s] business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of the law.

(d) A partner shall discharge the duties to the partnership and the other partners under this [Act] or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing.

(e) A partner does not violate a duty or obligation under this [Act] or under the partnership agreement merely because the partner's conduct furthers the partner's own interests.[73]

RUPA notably alters partnership law as it relates to expulsion.[74] Section 404 seems to permit partners to expel a colleague without breaching their duties of loyalty or care.[75] But such conclusions must be drawn cautiously given the scarcity of reported expulsion cases decided under section 404. In short, the potential effect of RUPA in general, and section 404 in particular, on law firm partner expulsion disputes is speculative.

Accepting as we must the lack of judicial guidance on this subject, several points may still be made. First, not all states that have adopted RUPA embrace the narrow fiduciary duties in sections 404(a) and (b).[76] It is thus important in cases governed by RUPA to examine controlling statutes instead of assuming the application of section 404 as drafted. Second, section 404(d) treats the duty of good faith and fair

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[73]ROBERT W. HILLMAN ET AL., THE REVISED UNIFORM PARTNERSHIP ACT § 404 (2007).

[74]Donald J. Nettles, Comment, *Do We Really Need Expulsion Provisions in Partnership Agreements: The Inadequacies of Partnership Law as It Relates to Law Partnerships*, 25 J. LEGAL PROF. 209, 213 (2001).

[75]*Id.* at 214.

[76]*See, e.g.*, Enea v. Superior Court, 34 Cal. Rptr. 3d 513, 517-18 (Ct. App. 2005) (discussing the different California approach to duty of loyalty).

dealing as a contract law concept.[77] RUPA does not define good faith and fair dealing, however, leaving that task to courts "based on the experience of real cases."[78] If case law develops as expected, courts will treat the good faith requirement "as an 'excluder'—a phrase with no general meaning or meanings of its own. Instead, it functions to rule out many different forms of bad faith."[79] Third, partners may not eliminate the duty of good faith and fair dealing through language in their partnership agreement, but they may agree on reasonable standards for its measure.[80] Finally, the section 404(e) statement that partners do not breach their duties to a co-partner or the partnership merely through self-interested conduct should not be interpreted to mean that partners may pursue their own interests without regard for their colleagues or firms.[81] Rather, partners may further their own interests without breaching any intra-firm duties if their actions are fully disclosed and are "fair to the partnership and the other partners."[82] In other words, there is self-interest and then there is something more, and partners cannot justify the latter—economically predatory behavior, for instance—by cloaking it in the protective fabric of section 404(e).

Regardless of the doctrinal underpinnings of the duty of good faith and fair dealing, it is true going forward, as it always has been, that the duty's contours are shaped by the facts of real cases. And so it is to those cases that we now turn.

III. LAW FIRM PARTNERSHIP EXPULSION IN THE COURTS

It is difficult to categorize the cases on good faith in law firm partnership expulsions because of the persistent concern that the ostensibly legitimate reasons offered by firms for ousting partners are pretextual. Also, cases may involve multiple and overlapping issues. This Part will characterize expulsion cases as involving (a) economically self-interested behavior by firms and their remaining partners, or (b) firms' response to disruptive or disharmonious conduct by partners. It will then analyze the line between good faith and bad faith in the expulsion context.

A. EXPULSION FURTHERING ECONOMIC SELF-INTEREST

Holman v. Coie[83] is the seminal case on bad faith in law firm partnership expulsions. *Holman* involved a law firm in Washington State with exceptionally close ties to the Boeing Company. Among the firm's twenty-two partners were two

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[77] ROBERT W. HILLMAN ET AL., THE REVISED UNIFORM PARTNERSHIP ACT § 404 cmt. 4 (2007).

[78] *Id.*

[79] *Id.* (quoting Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 262 (1968) (internal quotation marks omitted)).

[80] *Id.*

[81] Welch v. Via Christi Health Partners, Inc., 133 P.3d 122, 139 (Kan. 2006).

[82] *Id.* (quoting Edwin W. Hecker, Jr., *The Kansas Revised Uniform Partnership Act*, 68 J. KAN. B. ASS'N, 16, 32 (1999)).

[83] 522 P.2d 515 (Wash. Ct. App. 1974).

brothers, William and Francis Holman, both of whom sat on the firm's executive committee. Over the years, William Holman had questioned whether the firm was charging Boeing adequate fees and whether senior partners at the firm were pulling their own weight. There was, over time, discussion by other members of the executive committee about whether the Holmans should be asked to leave the firm given their perspectives. The Holmans viewed their provocative inquiries as business matters appropriate for executive committee consideration; they were unaware that they were upsetting the other members of the committee.[84]

In the mid- to late-1960s, Francis Holman was elected first to the Washington State House of Representatives and later to the State Senate. In his elected service, he took positions or made public statements that inflamed senior Boeing officials.[85] One Boeing official alleged that Francis exploited his attorney-client relationship with the company in connection with some legislation.[86]

On May 7, 1969, the executive committee, sans the Holmans and one other member who was overseas, convened secretly to discuss the Holmans' possible expulsion from the firm.[87] The committee favored expulsion but took no action then. Another executive committee meeting was convened on May 13 to which the Holmans were summoned and which was scheduled to accommodate Francis Holman's return from his legislative duties.[88] At this meeting, the executive committee, without giving reasons for their action, expelled the Holmans by a 7-2 vote.[89] The Holmans then sued the firm. The trial court dismissed the suit and the plaintiffs appealed to the Washington Court of Appeals.[90]

The firm's partnership agreement provided that any partner could be expelled by a majority vote of the executive committee.[91] The agreement did not require notice to subject partners, "a statement of reasons [for expulsion], a showing of good cause, or a hearing."[92]

The Holmans contended that the executive committee's actions on May 13 violated due process because they were not notified of their looming expulsions, the reasons for their expulsion were never specified, and they were afforded no opportunity to be heard.[93] The court rejected their arguments based on the express language of the partnership agreement, which required none of those things.[94] To

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[84] *Id.* at 517.

[85] *Id.* at 518.

[86] *Id.*

[87] *Id.* at 519.

[88] *Holman*, 522 P.2d at 519.

[89] *Id.*

[90] *Id.*

[91] *Id.*

[92] *Id.* (quoting The Partnership Agreement § 1.2).

[93] *Holman*, 522 P.2d at 521.

[94] *Id.* at 521-23.

accept the Holmans' arguments would require the court to re-write the partnership agreement, which it was unwilling to do.[95]

More to the point, the plaintiffs challenged their expulsions on the bases that they were not bona fide and were not in good faith, and contended that such requirements should be implied in the partnership agreement.[96] The plaintiffs' use of the term "bona fide" came from a Washington partnership statute based on the UPA; the reference to good faith came from a dictionary definition of "bona fide."[97] While recognizing that "partners in their dealings with each other must exercise good faith," the *Holman* court could not accept the plaintiffs' position.[98] The court reasoned that partners' good faith obligations to one another relate to the business aspects or property of their partnership.[99] In contrast, the "[p]laintiffs' claims [did] not relate to the business aspects or the property rights of the partnership. There [was] no evidence [that] the purpose of the severance was to *gain any business or property advantage* to the remaining partners."[100] The court therefore concluded that the firm had not breached its duty of good faith to the Holmans.[101]

Of course, the Holmans' expulsion did confer a business advantage to the firm and its remaining partners—it appeased the firm's most important client, Boeing. If Boeing were to move its business to another firm because of Francis Holman's aggravating legislative activities, the firm would suffer a business catastrophe. Indeed, whenever a firm expels a partner to preserve client relationships or the firm's reputation, the remaining partners receive a business or financial advantage.[102] Thus, following *Holman*, partners are permitted to obtain some level of business advantage through expulsion without being guilty of bad faith. Common sense and the nature of modern law practice demand as much. But where does one draw the good faith versus bad faith line? Conventional wisdom is that *Holman* draws the line at expulsions motivated by "an economically predatory purpose."[103]

In *Lawlis v. Kightlinger & Gray*,[104] the partner who was expelled, Lawlis, had become an alcoholic in 1982. He revealed his alcoholism to the firm in 1983. The firm supportively matched him with a physician specializing in the treatment of alcoholism.[105] The firm also required him to sign a contract setting forth conditions for his continued partnership, which specified that the firm would not give him a

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[95] *Id.* at 523.

[96] *Id.*

[97] *Id.*

[98] *Holman*, 522 P.2d at 523.

[99] *Id.*

[100] *Id.* (emphasis added).

[101] *Id.*

[102] Bohatch v. Butler & Binion, 977 S.W.2d 543, 552 (Tex. 1998) (Hecht, J., concurring).

[103] Vestal, *supra* note 31, at 1092.

[104] 562 N.E.2d 435 (Ind. Ct. App. 1990).

[105] *Id.* at 438.

"second chance" to right his career.[106] In early March 1984, Lawlis began abusing alcohol again, but the firm gave him a second chance when he sought treatment.[107] The firm imposed yet additional conditions on his continued partnership and reduced his partnership units, thereby reducing his compensation. The firm promised that Lawlis would be restored to full partnership, i.e., his partnership units would be increased, if he met the conditions imposed in his new behavioral contract.[108] Lawlis believed that he met those conditions and, in October 1986, proposed to the firm's finance committee that his partnership units be increased from 60 to 90 for 1987.[109] Instead, the finance committee recommended that the firm terminate him. The firm offered Lawlis a severance package including a six month period at reduced compensation to make a smooth transition out of the firm. When Lawlis declined this offer, the senior partners of the firm expelled him by a 7-1 vote in February 1987.[110]

Lawlis sued the firm for breach of contract. The trial court granted summary judgment for the firm. Lawlis then sought review by the Indiana Court of Appeals.[111]

The firm's partnership agreement provided that a partner could be expelled at any time by a two-thirds majority vote of the firm's senior partners upon such terms as the senior partners set.[112] Lawlis contended that his expulsion violated the duty of good faith and fair dealing implied in the partnership agreement because he was expelled for the predatory purpose of increasing the firm's lawyer-to-partner ratio for profitability purposes, which was a stated goal in the firm's five-year plan.[113] As he dramatically framed the argument:

> Obviously, the easiest way for the Partnership to improve its lawyer to partner ratio, and thus increase the top partners' salaries, was to eliminate a senior partner. Lawlis' position in the Partnership had been weakened by his absences due to illness. The remaining partners knew this and pounced upon the opportunity to devour Lawlis' partnership interest.[114]

The court in *Lawlis* agreed that if the power to expel partners granted in a partnership agreement is exercised in "bad faith," or, as Lawlis phrased it, for "a 'predatory purpose,'" then those exercising that power have breached the agreement.[115] But as the court saw it, Lawlis' claims of predatory purpose were

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[106] *Id.*

[107] *Id.*

[108] *Id.*

[109] *Lawlis*, 562 N.E.2d at 438.

[110] *Id.*

[111] *Id.*

[112] *Id.* at 439-40.

[113] *Id.* at 440.

[114] *Lawlis*, 562 N.E.2d at 440 (quoting Lawlis' appellate brief).

[115] *Id.*

belied by the firm's compassionate treatment of him during his period of intense alcoholism.[116] The firm carried him for years and even gave him a second chance to resurrect his career when he had contractually agreed that he would receive no second chance. Furthermore, instead of recommending his immediate expulsion, the firm had proposed a severance package and a six-month period of continued employment so that he might make a career transition. The undisputed facts demonstrated that the firm had acted in good faith in expelling Lawlis.[117]

Lawlis next claimed that the firm breached its fiduciary duty to him "by expelling him for the predatory purpose of increasing partner income," although he acknowledged that the fiduciary duty owed him was "intertwined with the duty of good faith and fair dealing."[118] The court rejected this argument, noting the potential harm to the firm that Lawlis' alcohol abuse posed and the firm's need to take corrective action.[119]

Summing up partners' duty of good faith and fair dealing owed to one another, the court explained:

> Where the remaining partners in a firm deem it necessary to expel a partner under a no cause expulsion clause in a partnership agreement freely negotiated and entered into, the expelling partners act in "good faith" regardless of motivation if that act does not cause a wrongful withholding of money or property legally due the expelled. . . .[120]

In this instance, the senior partners acted in the belief that the partnership agreement gave them the right to expel Lawlis as in fact it did.[121] There was no evidence that their decision was animated by greed. Thus, the court concluded that they acted in good faith.[122]

Lawlis is an interesting case for several reasons.[123] First, it illustrates the difficulty in categorizing expulsion cases as being based either on a firm's economic self-interest or the preservation of good will by removing disruptive partners because the facts suggest some of both. Second, the court's reliance on the firm's compassion toward Lawlis as evidence of its good faith was arguably misguided. The firm's five-year plan calling for an adjustment in its lawyer-to-partner ratio came out after Lawlis seemingly conquered his alcoholism and after he proposed an

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[116] *Id.* at 440-41.

[117] *Id.* at 441.

[118] *Id.* (quoting Lawlis' appellate brief).

[119] *Lawlis*, 562 N.E.2d at 442.

[120] *Id.* at 442-43.

[121] *Id.* at 443.

[122] *Id.*

[123] If you think about it, Lawlis' timing was horrible. After several years of being an unproductive partner and, indeed, a downright dangerous one, he sought a fifty percent increase in his compensation just as the firm was initiating its tough five-year plan. Would the firm—which had shown Lawlis great compassion as he struggled with his illness—have expelled him had he been content with 60 partnership units rather than seeking an increase to ninety? Lawlis might have been wise to remember that pigs get fat, hogs get slaughtered.

increase in his partnership units.[124] Times change, and the fact that the firm once showed Lawlis great compassion does not mean that the senior partners could not have seized on his illness as a pretext for expelling him once the firm's long-range planning process revealed to them the need to increase the firm's leverage. Third, why did the firm expel Lawlis when it did after carrying him for several years? The fact that the firm did not have to articulate cause for his expulsion does not mean that it was entitled to immunity. Was not the timing of the firm's decision suspicious?

The *Lawlis* court effectively adopted the *Holman* view that bad faith in the expulsion context requires an economically predatory purpose.[125] The underlying issue is whether the court correctly concluded that the firm's goal of increasing profits per partner in part by adjusting its lawyer-to-partner ratio as set forth in its five-year plan was not predatory. To be sure, the court charitably construed the plan in the firm's favor,[126] but that does not mean it erred. Law firms are businesses. The pursuit of increased profits is normal business behavior. Expelling partners who are not sufficiently contributing to the firm's profitability or who are dragging it down is a means of increasing firm profits. It seems probable that Lawlis' alcoholism prevented him from materially contributing to the firm's practice during the years immediately preceding his expulsion. On this record, the court simply could not have concluded that his expulsion was economically predatory.

The latest economic self-interest case to receive widespread attention is *Beasley v. Cadwalader, Wickersham & Taft.*[127] Beasley joined Cadwalader's Palm Beach, Florida office as a lateral partner in 1989. He was by all accounts "an extraordinary rainmaker and a skilled litigator."[128] The Palm Beach office's profitability increased significantly over the next three years, although it was somewhat of an uncomfortable place because of another senior partner's personality issues.[129] In 1993, the Palm Beach office lost money for the first time since Beasley came on board.[130] Also in 1993, Cadwalader's share value decreased by $11,000, a nettlesome development given that partners were compensated based on the number of their shares.[131] In 1994, the firm's share value decreased by another $15,000, upsetting a number of younger, highly productive partners. One of these partners, Link, made clear to the firm's management committee that if this course was not reversed, the younger group would leave.[132] Thus came "Project Right Size" through

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[124] *See Lawlis*, 562 N.E.2d at 438, 440 (providing a timing of events).

[125] *See id.* at 440, 442-43.

[126] *See id.* at 440-41 (discussing the firm's five-year plan as "read in full").

[127] No. CL-94-8646 "AJ", 1996 WL 438777 (Fla. Cir. Ct. July 23, 1996), *aff'd in part, rev'd in part*, 728 So. 2d 253 (Fla. Dist. Ct. App. 1998).

[128] *Id.* at *1.

[129] *Id.*

[130] *Id.*

[131] *Id.*

[132] *Beasley*, 1996 WL 438777, at *2.

which the firm aimed to identify "less productive partners for elimination from the partnership."[133]

Closing the Palm Beach office became a focus of Project Right Size, with the purpose being to improve the remaining partners' compensation and to retain the disgruntled young Turks.[134] "The watershed of the project was a clandestine all day management committee meeting" in early August 1994, which identified seventeen partners for expulsion, including all of the Florida partners.[135] The management committee finally voted to close the Palm Beach office in late August 1994.[136] The management committee's plan to expel seventeen partners met opposition, but the partnership endorsed it by a 67-12 vote in October.[137]

One day after the second management committee meeting, the firm informed the Palm Beach partners that their office would close at the end of the year. In September 1994, the co-chair of the management committee, Glascoff, went to Palm Beach to talk to the partners. While he said that the management committee would consider allowing some of them to transfer to New York, he and Beasley agreed it would be impractical for Beasley to do so.[138] Indeed, the trial court would later find that Beasley's transfer from Florida to New York (or to Washington, D.C., as was further discussed) was so grossly impractical that the firm's offer of it could not have been made in good faith.[139]

Beasley and the firm unsuccessfully attempted to negotiate terms for his departure for approximately two months.[140] By November, their relationship had deteriorated to the point that Beasley sued the firm for wrongful expulsion and for breaching its fiduciary duties to him.[141] The firm rousted Beasley from his office shortly thereafter.[142]

The case was decided under New York law, which follows the UPA.[143] The Cadwalader partnership agreement contained no expulsion clause.[144] Thus, if the firm expelled Beasley, it breached the agreement.[145] If Beasley withdrew from the firm, on the other hand, there was no breach. Cadwalader urged that Beasley had withdrawn because (1) "the management committee had the power to close branch

[133] *Id.*

[134] *Id.* at n.2.

[135] *Id.* at *2.

[136] *Id.*

[137] *Beasley*, 1996 WL 438777, at *3.

[138] *Id.*

[139] *Id.*

[140] *Id.*

[141] *Beasley*, 1996 WL 438777, at *1 (stating claims); *id.* at *3 (giving date litigation commenced).

[142] *Id.* at *3.

[143] *See id.* at *4.

[144] *Id.* at *3.

[145] *Beasley*, 1996 WL 438777, at *3.

offices" and thus, it was impossible for him to have been expelled; and (2) the firm offered him partnership in New York or Washington.[146] The trial court rejected both arguments.

Although it was clear that the firm's management committee had the power to close branch offices as part of its overall managerial authority, it was equally clear given the lack of related language in the partnership agreement that it did not have the power to expel partners in those offices (or anywhere else, for that matter).[147] As noted earlier, it was not practical for Beasley to transfer to New York or Washington. Given that his practice was rooted entirely in Florida, he would have arrived in either office with no business, and the firm was expelling unproductive partners both places. Nothing about such a transfer made sense.[148] Thus, the court determined that the firm's offer of a transfer could not have been made in good faith and Beasley was justified in declining it.[149]

Cadwalader's argument that Beasley had withdrawn from the partnership by suing the firm was undone by a lack of supporting authority. While the firm could offer no cases to support its position, Beasley amassed numerous cases holding that if a suit for dissolution of a partnership is non-frivolous, it cannot constitute a voluntary withdrawal. Moreover, New York partnership statutes expressly contemplated suits between partners.[150] The trial court therefore concluded that Beasley had not voluntarily withdrawn from the firm.[151]

It was clear to the trial court that Cadwalader had expelled Beasley.[152] That brought the court to Beasley's breach of fiduciary duty claim. Beasley alleged that the firm breached its fiduciary duty to him by expelling him in violation of the partnership agreement, by not disclosing its plan to close the Palm Beach office and terminate the partners there, and "[b]y expelling him and the other partners for the financial gain of the remaining partners."[153]

In evaluating the firm's fiduciary duty, the trial court seized upon Justice Cardozo's opinion in *Meinhard v. Salmon*.[154] In that opinion, Cardozo wrote that co-partners owe each other a "duty of the finest loyalty" and explained that for those who owe fiduciary duties, as partners do, "[n]ot honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."[155] This, the trial court determined, was the standard by which Cadwalader's actions had to be judged.[156]

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[146] *Id.*

[147] *Id.* at *4.

[148] *Id.* at *3.

[149] *Beasley*, 1996 WL 438777, at *4.

[150] *Id.*

[151] *Id.*

[152] *See id.* at *5 (explaining reasoning).

[153] *Id.*

[154] 164 N.E. 545 (N.Y. 1928).

[155] *Id.* at 546.

[156] *Beasley*, 1996 WL 438777, at *5.

The trial court found that Beasley and the other partners were ousted for the "express purpose of producing greater profits for the remaining partners."[157] The management committee could have avoided trouble by proposing to the partnership that it amend the partnership agreement to allow for expulsion.[158] Instead of doing that, as one partner had wisely proposed, the committee "ben[t] to the will of the disgruntled partners by expelling other partners to whom they owed a fiduciary duty."[159] This was not an instance of the management committee simply fulfilling its managerial function. "Rather, [the committee] was participating in a clandestine plan to wrongfully expel some partners for the financial gain of other partners."[160] There was no way to describe such activity as "honorable," much less to find that it comported with "the punctilio of an honor[.]"[161]

Next, the trial court considered the firm's defense based on Beasley's unclean hands. As it turned out, Beasley was planning on leaving Cadwalader during the spring and early summer of 1994.[162] He had even approached three Cadwalader associates about joining him at a new firm starting in September 1994. Naturally, he did not disclose his plans to the firm.[163] Beasley and his potential new partner could not reach an agreement, however, and his new venture never launched.[164] The trial court found that Beasley had not breached his fiduciary duty to Cadwalader by secretly planning to start a new firm, but, even if he had, it would be inequitable to allow his actions to trump Cadwalader's more egregious conduct.[165] As the trial court colorfully summarized matters, "[i]f Beasley had dirt under his fingernails, [Cadwalader] was up to its elbows in the dung heap."[166]

The trial court concluded that Beasley was entitled to recover punitive damages for Cadwalader's breach of fiduciary duty.[167] As the court explained:

> When [a] partnership encounters foul weather, the partners must either all stay the course or all abandon it. Under the facts of this case, it was a gross breach of fiduciary duty for some partners to throw others overboard for the expediency of increased profits. . . . [T]hese facts establish at least conduct which was so reckless as to amount to a conscious disregard for the rights of Beasley and the other expelled partners.[168]

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[157] *Id.* at *6.

[158] *See id.*

[159] *Id.*

[160] *Beasley*, 1996 WL 43877, at *6.

[161] *Id.* (quoting Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928)).

[162] *Id.*

[163] *Id.*

[164] *Id.*

[165] *Beasley*, 1996 WL 438777, at *6.

[166] *Id.*

[167] *Id.* at *9.

[168] *Id.* at *7.

The court ultimately awarded Beasley compensatory and punitive damages totaling nearly $2.5 million, plus interest.[169]

Cadwalader appealed the judgment. The appellate court accepted the trial court's reasoning with respect to liability.[170] The appellate court also affirmed the punitive damage award.[171] In some consolation to the firm, the appellate court did reverse and remand with respect to two components of the trial court's compensatory damages award.

Of the cases to date, *Beasley* holds law firms to the highest standard of conduct when expelling partners. The lack of an expulsion provision in the firm's partnership agreement, however, doubtlessly colored the trial court's judgment.[172] There obviously would have been no breach of the partnership agreement had it included an expulsion provision, but beyond that, the trial court's harsh criticism of the firm might have been softened had there been an expulsion clause arguably permitting the firm to act as it did. Regardless, the lack of an expulsion clause in the Cadwalader partnership agreement is a major distinguishing factor should other courts or litigants be tempted to rely on *Beasley* when analyzing expulsion-related liability. As for those who would disregard the case on the basis that the most damning language appears in the non-precedential trial court opinion, consider that the appellate court did not disturb the trial court's liability findings and affirmed the punitive damage award.[173] Thus, while it may be possible to discount the case as principally being the handiwork of an inferior court, it cannot safely be ignored on those grounds.

B. *Expulsions to Preserve Trust or Reputation*

Law firms expel partners for reasons other than exclusively economic self-interest. Firms may expel lawyers to preserve or protect intra-firm relationships, preserve their good will or reputations, mitigate or punish objectively disruptive or destructive behavior, or preserve the personal confidence and trust essential to partnership.[174] It is not bad faith to expel a partner to resolve a partnership schism.[175] On the other hand, claims of disruption or embarrassing, incompatible or disreputable conduct cannot be used to excuse a firm's predatory or retaliatory

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[169] *Id.* at *9.

[170] Cadwalader, Wickersham & Taft v. Beasley, 728 So. 2d 253, 255-56 (Fla. Dist. Ct. App. 1998).

[171] *Id.* at 258-59.

[172] At least one other Cadwalader partner expelled as result of Project Right Size sued the firm. Alan Ruskin won a $3 million jury verdict. Ruskin's case is not the subject of a reported opinion. Vestal, *supra* note 31, at 1104-05.

[173] *Beasley*, 728 So. 2d at 255, 258-59.

[174] *See, e.g.*, Hogan v. Morton, No. 03A01-9206-CH-00214, 1993 WL 64220, *1 nn.1, 6 (Tenn. Ct. App. Mar. 10, 1993) (involving partner who was expelled for his affair with a married associate; there was a question of fact about the existence of a partnership agreement containing an expulsion provision and the plaintiff's rights under it).

[175] Waite v. Sylvester, 560 A.2d 619, 623 (N.H. 1989); Leigh v. Crescent Square, Ltd., 608 N.E.2d 1166, 1171 (Ohio Ct. App. 1992).

expulsion of a partner. There is no room for pretext here. Partners are owners of their firms and they are entitled to reasonably dissent from firm decisions and to question decisions made by firm leaders or managers. Not every disagreement within a partnership, even if impassioned or prolonged, qualifies as a "schism." A firm cannot expel a partner on the basis that her continued presence would be disruptive or fractious when the partner is simply exercising her rights under the partnership agreement.[176] This is true even if the agreement does not require cause for expulsion, or permits expulsion for any reason. The discretion conferred upon partners under a partnership agreement, no matter how broad, cannot "abrogate their high duty to exercise good faith and fair dealing in the execution of such discretion."[177]

Firms' concerns about their reputations and disruptive internal relationships may have economic overtones, of course, and sometimes internal and external considerations become inextricably intertwined when the subject is a partner's expulsion. That was the situation in *Heller v. Pillsbury Madison & Sutro*.[178]

Philip Heller joined the Los Angeles office of the firm once known as Pillsbury Madison & Sutro as a lateral partner in January 1990.[179] In February 1991, he was quoted in a story in local society magazine as bragging about dating "an embarrassing number of women."[180] The photo accompanying the story showed him leaning against his Porsche. The same month, he attempted to land Apple Computer's employment litigation work and, in the process, sabotaged efforts by a fellow partner who was attempting to do the same thing. Though the extent of Heller's treachery vis-à-vis his fellow partner may not have been apparent to Apple, the company decided not to hire Pillsbury because the firm appeared to be disorganized and uncoordinated.[181] Later, Heller caused the firm some difficulty when he attempted to bring in a new matter for the Reebok Company outside of the firm's normal procedure for checking conflicts of interest.[182]

The relationship between Pillsbury and Heller increasingly soured in May and June 1992 as a result of Heller's bizarre communications with executives at Bank of America (the "Bank"), one of Pillsbury's most important clients. The Bank's general counsel, Michael Halloran (a former Pillsbury partner in the firm's San Francisco office), had been featured in a story in *American Lawyer* magazine.[183] On May 21, 1992, Heller wrote Halloran a letter stating that Halloran's picture accompanying the story was "almost a caricature of what Michael Lewis described

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[176] *See, e.g.*, Winston & Strawn v. Nosal, 664 N.E.2d 239, 243-46 (Ill. App. Ct. 1996) (involving partner who was seeking access to firm's books and records as provided for in partnership agreement).

[177] *Id.* at 246.

[178] 58 Cal. Rptr. 2d 336 (Ct. App. 1996).

[179] *Id.* at 339.

[180] *Id.* at 340 (quoting *Why L.A. Men Won't Commit*, LOS ANGELES MAG., Feb. 1991).

[181] *Id.*

[182] *Id.*

[183] *Heller*, 58 Cal. Rptr. 2d at 341.

in Liar's Poker [*sic*] as 'One big swinging dick.'"[184] Heller sent a copy of the letter to the Bank's CEO, Richard Rosenberg.[185] On May 27, Heller sent Halloran a copy of a story about a husband who went to his secretary's apartment for a sexual liaison and disrobed, only to find his wife and children there.[186] Heller also copied Rosenberg on this mailing.[187] This prompted one of Halloran's senior subordinates, David Grimes, to call Rodney Peck, a Pillsbury partner and a member of the firm's executive committee, to ask that Heller send no more letters to Rosenberg.[188] Grimes believed that if Heller's letters did not stop, the Bank would terminate its relationship with Pillsbury. It is unclear whether Grimes knew at the time about Heller's May 27 letter. Peck certainly did not, because he queried Heller as to whether he had written Halloran since May 21, and Heller denied doing so.[189] Heller then asked Peck whether he should apologize to either Halloran or Rosenberg, and Peck told him no. Heller disobeyed Peck and wrote a letter of apology to Rosenberg on June 2.[190]

On June 9, the firm's executive committee met to consider Heller's expulsion from the firm. The committee discussed the magazine article in which Heller boasted of his romantic prowess, Heller's disruptive behavior in attempting to attract Apple's employment business, the Reebok matter, Heller's communications with the Bank, and his performance overall.[191] The committee approved Heller's expulsion. The next day, Grimes called Peck about the May 27 and June 2 letters and told him that the Bank would remove Pillsbury from its list of approved outside counsel if it received one more letter from Heller.[192]

Grimes' second call spurred the firm to immediate action.[193] Several members of the executive committee hastily met with Heller and offered him a chance to resign from the firm. When he refused, the firm expelled him.[194]

Heller sued the firm and several partners on a variety of theories and his case reached the California appellate courts after the trial court dismissed some of his claims and a jury could not reach a verdict on others.[195] Among other things, Heller argued that the executive committee breached the partnership agreement by expelling him without cause. This claim went nowhere because the agreement

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[184] *Id.* (quoting Letter from Philip Heller to Michael Halloran, Executive Vice president and Gen. Counsel of Bank of Am. (May 21, 1992)).

[185] *Id.*

[186] *Id.*

[187] It may be inferred that Heller copied Rosenberg on both mailings as Grimes asked Peck "that no more *letters* be sent to Rosenberg." *Id.* (emphasis added).

[188] *Heller*, 58 Cal. Rptr. 2d at 341.

[189] *Id.*

[190] *Id.*

[191] *Id.*

[192] *Id.*

[193] *Heller*, 58 Cal. Rptr. 2d at 341.

[194] *Id.* at 342.

[195] *Id.*

clearly provided for expulsion without cause.[196] His argument that his expulsion violated the firm's implied duty of good faith and fair dealing was equally unavailing, given that the partnership agreement authorized expulsions "through 'the guillotine approach'" and the firm expelled him pursuant to the agreement.[197]

Heller further contended that the trial court erred when it rejected his claims for breach of fiduciary duty. The court in *Heller* recognized that partners owe each other and their firm a fiduciary duty.[198] But that duty attaches only "where one partner could take advantage of his position to reap personal profit or act to the partnership's detriment."[199] There was no evidence that Pillsbury expelled Heller to enrich the remaining partners.[200] When he was expelled, Heller was compensated at the low end of the firm's compensation range and the firm had more than 200 partners.[201] Any benefit that flowed to the remaining partners was therefore so insubstantial as to be immaterial to the decision to expel him.[202]

More important, however, was the effect of Heller's behavior on the firm.[203] The evidence revealed that the executive committee had expelled him because it lost trust in him.[204] The *Heller* court adopted this reasoning from the Washington Court of Appeals' decision in *Holman v. Coie*:[205]

> The foundation of a professional relationship is personal confidence and trust. Once a schism develops, its magnitude may be exaggerated rightfully or wrongfully to the point of destroying a harmonious accord. When such occurs, an expeditious severance is desirable. To imply terms not expressed in this partnership agreement frustrates the unambiguous language of the agreement and the result contemplated.[206]

The court accordingly affirmed the trial court's dismissal of Heller's breach of fiduciary duty claim.[207]

Heller makes clear that firms may expel partners in whom they have lost trust as a result of disruptive or disreputable behavior. Heller embarrassed the firm through his public quote, he greedily sabotaged a fellow partner's business development efforts, he refused to comply with firm business intake procedures, he lied to an

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[196] *Id.* at 346.

[197] *Id.* at 347 (quoting Holman v. Coie, 522 P.2d 515, 523-24 (Wash. Ct. App. 1974)).

[198] *Heller*, 58 Cal. Rptr. 2d at 348.

[199] *Id.* (quoting Leigh v. Crescent Square, Ltd., 608 N.E.2d 1166, 1170 (Ohio Ct. App. 1992)).

[200] *Id.*

[201] *Id.* at 348 n.7.

[202] *Id.* at 348.

[203] *Heller*, 58 Cal. Rptr. 2d at 348.

[204] *Id.*

[205] 522 P.2d 515 (Wash. Ct. App. 1974).

[206] *Heller*, 58 Cal. Rptr. 2d at 348 (quoting *Holman*, 522 P.2d at 524).

[207] *Id.*

executive committee member, and he disobeyed the same executive committee member's reasonable instruction. Even if Heller's bizarre mailings to Halloran and Rosenberg had not jeopardized the firm's client relationship with the Bank, they were so outrageously inappropriate as to have destroyed other partners' faith and trust in him. Heller's expulsion was handsomely justified.

Although firms' ability to expel partners because of a loss of trust in them free from the fear of associated liability requires recognition, that ability must have reasonable limits. A Texas case, *Bohatch v. Butler & Binion*,[208] represents a troubling test of those limits.

Before launching into a discussion of the decision in *Bohatch*, a little background is in order. Most jurisdictions require lawyers to report serious misconduct by other lawyers to disciplinary authorities on pain of professional discipline if they do not.[209] This requirement derives from Model Rule of Professional Conduct 8.3(a), which provides: "A lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, shall inform the appropriate professional authority."[210] Billing fraud clearly requires reporting under Rule 8.3(a).

Returning now to the case, Colette Bohatch was a partner in the Washington, D.C. office of Texas-based Butler & Binion.[211] John McDonald was the office's managing partner, and another partner, Richard Powers, also worked there. The three lawyers worked mostly on Pennzoil business. As a partner, Bohatch received firm reports on lawyers' billings. Reviewing these reports, she became concerned that McDonald was overbilling Pennzoil.[212] She discussed the matter with Powers, and they jointly reviewed McDonald's time records, which heightened her concerns.[213] As a result, she reported her concerns to the firm's managing partner, Louis Paine, and to two members of the firm's management committee, R. Hayden Burns and Marion McDaniel.[214] Paine and Burns investigated Bohatch's complaint. They reviewed Pennzoil bills and supporting records, and they also spoke with Pennzoil in-house lawyer John Chapman, the firm's primary contact at the company.[215] He told them that Pennzoil found McDonald's bills to be reasonable.[216]

In August 1990, Paine met with Bohatch and reported that the firm's investigation had cleared McDonald. Continuing, he told her that she should begin

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

[209] Douglas R. Richmond, *Law Firm Partners as Their Brothers' Keepers*, 96 KY. L.J. 231, 252 (2008).

[210] MODEL RULES OF PROF'L CONDUCT R. 8.3(a) (2008).

[211] *Bohatch*, 977 S.W.2d at 544.

[212] *Id.*

[213] *Id.*

[214] *Id.*

[215] *Bohatch*, 977 S.W.2d at 544.

[216] *Id.*

seeking other employment.[217] The firm promptly stopped assigning her work.[218] In January 1991, the firm denied Bohatch her year-end partnership distribution for 1990 and erased her expected compensation for 1991 by reducing her tentative partnership distributions to zero.[219] The firm stopped paying her in June 1991.[220] In August 1991, the firm told her to vacate her office by November.[221] Bohatch found new employment by September 1991. She sued the firm in late October 1991, and the firm expelled her three days later.[222]

Bohatch alleged three theories of liability in her suit: wrongful discharge, breach of fiduciary duty, and breach of the firm's partnership agreement based on the duty of good faith and fair dealing.[223] The trial court granted Butler & Binion partial summary judgment on Bohatch's wrongful discharge claim and on her claims for breach of fiduciary duty and breach of the duty of good faith and fair dealing for conduct occurring after her she was expelled.[224] The trial court allowed the remaining claims for conduct occurring before her expulsion to go to trial, and a jury found that the firm breached its fiduciary duty and had breached its partnership agreement.[225] Bohatch ultimately was awarded $307,000 in compensatory damages and $237,000 in punitive damages.[226] Both sides appealed.

The Texas Court of Appeals concluded that Butler & Binion's only duty to Bohatch was not to expel her in bad faith, which, in this context, would have required that the firm expel her for the remaining partners' self-gain.[227] There was no evidence of that, and thus, the court of appeals determined that the firm did not breach its fiduciary duty to her.[228] The court of appeals did conclude, however, that the firm breached its partnership agreement and that Bohatch was accordingly entitled to damages of $35,000, plus attorney's fees of $225,000.[229] Bohatch then sought review in the Texas Supreme Court.

The Texas Supreme Court observed that, while partnership is a fiduciary relationship and imposes upon partners duties of loyalty and utmost good faith, "partners have no obligation to remain partners" forever.[230] Partnership is at heart a

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[217] *Id.*

[218] *Id.*

[219] *Id.*

[220] *Bohatch*, 977 S.W.2d at 544-45.

[221] *Id.* at 545.

[222] *Id.*

[223] *Id.*

[224] *Id.*

[225] *Bohatch*, 977 S.W.2d at 545.

[226] *Id.*

[227] *Id.*

[228] *Id.*

[229] *Id.*

[230] *Bohatch*, 977 S.W.2d at 545.

voluntary association.[231] This case presented an issue of first impression in Texas; that is, whether co-partners' fiduciary relationship "creates an exception to the at-will nature of partnerships . . . ."[232] More particularly, the court was asked whether co-partners' fiduciary obligations give rise to a duty not to expel a partner who reports a colleague's suspected overbilling.[233]

Butler & Binion's partnership agreement neither specified nor limited the grounds for expelling a partner.[234] There were no applicable Texas statutes. That left the court looking to the common law of partnership to resolve Bohatch's claims.[235]

The Supreme Court of Texas observed that courts in other states had held that partnerships could expel partners for business reasons, to protect relationships within the partnership and with clients, and to resolve a schism within the firm.[236] "The fiduciary duty that partners owe one another does not encompass a duty to remain partners or else answer in tort damages."[237] Nonetheless, Bohatch and several legal scholars supporting her as amicus curiae argued that public policy considerations compelled the recognition of a limited duty to retain partners who blow the whistle on co-partners' suspected misconduct.[238] Such an extension of partners' fiduciary duty was necessary, they argued, "because permitting a law firm to retaliate against a partner who in good faith reports suspected overbilling would discourage compliance with rules of professional conduct and thereby hurt clients."[239] While recognizing that this argument was forceful, the court rejected it, explaining:

> A partnership exists solely because the partners choose to place personal confidence and trust in one another. Just as a partner can be expelled, without a breach of any common law duty, over disagreements about firm policy or to resolve some other "fundamental schism," a partner can be expelled for accusing another partner of overbilling without subjecting the partnership to tort damages. Such charges, whether true or not, may have a profound effect on the personal confidence and trust essential to the partner relationship. Once such charges are made, partners may find it impossible to continue to work together to their mutual benefit and the benefit of their clients.[240]

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[231] *Id.* (citing Gelder Med. Group v. Webber, 363 N.E.2d 573, 577 (N.Y. 1977)).

[232] *Id.*

[233] *Id.*

[234] *Id.* at 546.

[235] *Bohatch*, 977 S.W.2d at 546.

[236] *Id.*

[237] *Id.*

[238] *Id.*

[239] *Id.*

[240] *Bohatch*, 977 S.W.2d. at 546-47 (citation omitted).

Two dissenting justices warned that the permission of "retaliation against a partner who tries in good faith to correct or report perceived misconduct virtually assures that others will not take these appropriate steps in the future[,]" and that the court's approach would send "an inappropriate signal . . . that the rules of professional responsibility are subordinate to a law firm's other interests."[241] The majority was sensitive to this concern but reasoned that it was secondary to the preservation of trust between partners.[242] Furthermore:

> [T]he dissenting justices d[id] not explain how the trust relationship necessary both for the firm's existence and for representing clients can survive such serious accusations by one partner against another. The threat of tort liability for expulsion would tend to force partners to remain in untenable circumstance—suspicious of and angry with each other—to their own detriment and that of their clients whose matters are neglected by lawyers distracted with intra-firm frictions.[243]

In a concurring opinion, Justice Hecht criticized the court for failing to address the dissenting justices' concern that upholding Bohatch's expulsion would discourage lawyers from reporting unethical conduct.[244] He attempted to sidestep this issue in his concurrence by focusing on the fact that Bohatch's concerns were unfounded. He reasoned that her expulsion for reporting McDonald's perceived overbilling could not be a breach of fiduciary duty because "a mistake so serious indicates a lack of judgment warranting expulsion[,]" and it is indisputable that a firm may expel a partner "for a serious error in judgment" in client or firm affairs.[245] As Justice Hecht analyzed matters, if Bohatch and McDonald had disagreed about tactics in a case or Washington office operations, "the firm could have determined that she should be expelled for the health of the firm, even if [she] had acted in complete good faith. Reporting unethical conduct where none existed is no different."[246]

The court's majority was unmoved by Justice Hecht's reasoning. His approach did not encourage lawyers' compliance with ethics rules any more than the approach the court adopted. Bohatch and amici argued simply that a reporting attorney must act in good faith, not that she be right.[247] As the court saw it, their policy concerns were best served by a clear demarcation of lawyers' ethical duties and partners' tort liability.[248] At the same time, the court held partners to their ethical duty to report colleagues' misconduct.

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[241] *Id.* at 561 (Spector, J., dissenting).

[242] *Id.* at 547 (majority opinion).

[243] *Id.*

[244] *Id.* at 556 (Hecht, J., concurring).

[245] *Bohatch*, 977 S.W.2d at 555.

[246] *Id.*

[247] *Id.* at 547.

[248] *Id.*

> We emphasize that our refusal to create an exception to the at-will nature of partnerships in no way obviates the ethical duties of lawyers. Such duties sometimes necessitate difficult decisions. . . . The fact that the ethical duty to report may create an irreparable schism between partners neither excuses failure to report nor transforms expulsion as a means of resolving that schism into a tort.[249]

The court concluded that the firm "did not owe Bohatch a duty not to expel her" for reporting McDonald's alleged overbilling.[250] The court did agree, however, that the firm had breached its partnership agreement by reducing Bohatch's tentative 1991 partnership distributions to zero; it therefore affirmed the court of appeals' judgment.[251]

As I recently explained in another article, *Bohatch* is a rotten decision from a policy standpoint.[252] The opinion discourages partners from reporting colleagues' serious ethical breaches. This is a policy error with consequences for clients because:

> There are cases in which partners' misconduct, despite being serious, is so subtle that it is likely to be discovered only by another lawyer in the same firm. If another partner discovers the misconduct but fears retaliation if she reports it, she has no incentive to make a report because there is a strong possibility that the misconduct will never come to light otherwise. Under *Bohatch*, the fact that her report of her fellow partner's misconduct would be made in good faith will not spare her expulsion. It is the client who suffers in the end.[253]

The *Bohatch* court's approach is variously suspect. For example, in discounting the dissent's concern that the decision would subordinate lawyers' professional responsibilities, the court asserted that the dissent had not explained how the trust necessary "for the firm's existence and for representing clients [could] survive such serious accusations by one partner against another."[254] Furthermore, the threat of tort liability for expulsion on these facts would supposedly force partners to work together bathed in anger and suspicion, with corresponding detrimental effects on them and on their clients, whose matters the lawyers would neglect because of the distractions caused by intra-firm frictions.[255]

There are at least six flaws in this reasoning. First, it should have been apparent to the court that the firm could survive Bohatch's allegations about McDonald given that Powers also reviewed McDonald's time records for overbilling and the firm did not expel him. It is no answer to say that Powers did not join in complaining to firm

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[249] *Id.*

[250] *Bohatch*, 977 S.W.2d at 547.

[251] *Id.*

[252] Richmond, *supra* note 209, at 256.

[253] *Id.* at 257 (footnotes omitted).

[254] *Bohatch*, 977 S.W.2d at 547.

[255] *Id.*

management because his stealthy check of McDonald's honesty was just as likely to foster distrust among other partners. Second, firm leaders were perfectly poised to suppress any anger or dispel any suspicion. All they needed to do was remind the partnership that Bohatch was ethically bound to act as she did.[256] They could have further explained to the other partners that had she failed to act, she might have violated her duty of care to the law firm.[257] Third, the other partners could not afford to let any anger or suspicion attributable to her behavior detract from clients' representations because doing so would expose them to professional discipline for violating their duties of competence and diligence,[258] and would open them to potential malpractice liability. Fourth, if the firm was seriously fractured by Bohatch's allegations, the partners could have dissolved it and reformed with a more harmonious makeup. Although dissolution is an unappealing option, it is preferable to permitting a firm to expel a partner for honoring her ethical duties. Dissolution certainly solves the problem of forcing partners to remain together in a hostile environment. Fifth, if only a few partners at Butler & Binion were aggrieved by Bohatch's actions, was it not more fair to require them to leave the firm? Nothing bound them to continued partnership with Bohatch. In contrast, Bohatch reasonably believed that her actions were compelled by ethics rules. Sixth, at-will employment is also a voluntary association, yet the law commonly protects employees who, for example, file workers' compensation claims or report public safety hazards to officials. Employers cannot fire at-will employees who engage in legally protected activities on the basis that their continued presence in the workplace would fuel anger or suspicion. The court never articulated in any meaningful fashion how this case was different.

In short, expelling a partner for good faith compliance with ethics rules is materially different from expelling a partner for other behaviors potentially causing friction within a law firm. The Texas Supreme Court should have held that Butler & Binion's expulsion of Bohatch was an act of bad faith. *Bohatch* was wrongly decided, and other courts should not follow it.

C. Summary and Analysis

It is clear from the case law that courts will strictly enforce unambiguous partnership agreements. Courts are undisturbed by the guillotine approach to partner expulsion. Ever lurking, however, is the possibility that a firm's offered justifications for a partner's ouster are pretextual and that the expulsion violated the remaining partners' duty of good faith and fair dealing. So what does the duty of good faith and fair dealing in this context require? Relatively little, it seems. Firms may expel partners without fear of related liability where they have a legitimate business purpose, as where a partner's conduct threatens a key business relationship, is seriously disruptive within the firm, or somehow threatens to bring the firm into

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[256] *See* MODEL RULES OF PROF'L CONDUCT R. 5.1(a) (2008) (imposing on all partners in a law firm a duty to see that "the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct").

[257] *See* WILLIAM A. GREGORY, THE LAW OF AGENCY AND PARTNERSHIP 292 (3d ed. 2001) (discussing partners' duty of care to their partnerships).

[258] *See* MODEL RULES OF PROF'L CONDUCT R. 1.1 (2008) (requiring competence); *id.* R. 1.3 (mandating diligence).

disrepute.[259] The cases to date suggest that firms breach their duty of good faith and fair dealing where a partnership agreement permits guillotine expulsion only if they expel a partner for economically predatory purposes,[260] or in retaliation for exercising rights conferred by a partnership agreement.[261]

Given the relative lack of case law, however, it is worthwhile asking how future courts should analyze the duty of good faith and fair dealing in law partnership expulsions. There seemingly are two principal options. The first is the "excluder" method articulated in the comments to section 404 of RUPA.[262] Under this approach, the term "good faith and fair dealing" has no "general meaning or meanings of its own[,]" but instead operates "to rule out many different forms of bad faith."[263] In other words, "good faith and fair dealing" means simply the absence of bad faith and unfair dealing. The term's precise meaning will vary with case facts.[264] The second option is so-called "cost-of-contracting analysis."[265] Cost-of-contracting analysis asks whether discretion in performing the contract is exercised for a purpose reasonably within the parties' contemplation or reasonable expectations.[266] The parties' expectations are determined from the contract language, or, if the contract is unclear, from its purpose.[267] If the party vested with discretion exercises that discretion to recapture its cost of contracting or to deprive the other party of the benefit of her bargain, it breaches its duty of good faith and fair dealing.[268]

Assume, for example, that a firm expels several partners for deficient performance as objectively measured, whether tied to business development or billable hours. The firm's partnership agreement provides for guillotine severance. Under the excluder approach, these expulsions would not violate the duty of good faith and fair dealing. They were motivated not by the remaining partners' desire to seize money or property due the ousted partners, or to otherwise take advantage of them. Nor would these expulsions be in bad faith under the cost-of-contracting approach. The firm did not expel the partners to recoup the cost of their original agreement, i.e., the foregone opportunity to keep all firm profits to themselves.[269]

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[259] *See, e.g.*, Heller v. Pillsbury Madison & Sutro, 58 Cal. Rptr. 2d 336, 346-50 (Ct. App. 1996).

[260] *See* Lawlis v. Kightlinger & Gray, 562 N.E.2d 435, 442-43 (Ind. Ct. App. 1990); Holman v. Coie, 522 P.2d 515, 523 (Wash. Ct. App. 1974).

[261] Winston & Strawn v. Nosal, 664 N.E.2d 239, 244 (Ill. App. Ct. 1996).

[262] ROBERT W. HILLMAN ET AL., THE REVISED UNIFORM PARTNERSHIP ACT § 404 cmt. 4 (2007).

[263] *Id.*

[264] *Id.*

[265] Dalley, *supra* note 11, at 199.

[266] *Id.* (citing STEVEN J. BURTON & ERIC G. ANDERSON, CONTRACTUAL GOOD FAITH 3.4.1, at 54 (1995)).

[267] *Id.* at 199-200.

[268] *Id.* at 200.

[269] *See id.* at 200-02 (explaining cost-of-contracting analysis).

The ousted partners could not have reasonably expected to remain partners indefinitely if they did not contribute to the firm's profitability.

Now let's change the facts. In this scenario, a law firm expels a number of partners for the purpose of increasing its overall profitability. The remaining partners will see their profits increase as a result of the expulsions; indeed, that is their goal. The partners who are expelled perhaps do not work as hard or produce as much business as those who remain, but they are not disruptive and they are by no means shirking. The outcome in this scenario is much more difficult to predict. The decision in *Beasley v. Cadwalader, Wickersham & Taft*[270] suggests that the firm could very well be found guilty of bad faith under excluder analysis.[271] The fact that the firm is not as profitable as some partners apparently prefer does not mean they are permitted to throw their mates overboard. "While life in the market place may well be made up of fear, greed and money, life in a partnership is not so composed."[272] If a firm must endure declining profits in the spirit of partnership, as *Beasley* arguably indicates, then a firm cannot in good faith expel partners when it is operating profitably, even if not ideally or optimally so.

The firm might also lose this case under a cost-of-contracting analysis because the remaining partners' actions are motivated by personal financial gain.[273] The remaining partners "are seeking to avoid a cost of their original agreement—the foregone opportunity to keep all the [firm's] profit[s] for themselves."[274] Nor did the expelled partners reasonably expect that the firm would become so successful that their colleagues would squeeze them out in order to hoard all the profits.[275] These expulsions are not for the good of the firm, which would legitimize them[276]; they are for the good of select members of the firm and knowingly detrimental to others.

On the other hand, the firm would understandably contend that its partnership status does not change the fact that it is a profit-making enterprise and all partners know that when they are admitted to the partnership. Lawyers understand the marketplace. The fact that the expelled partners were not shirking and were good firm citizens does not mean that they were performing up to expectations. Moreover, the pursuit of increased profits is normal business activity. The firm must do whatever is necessary to retain the highest-performing partners if it is to succeed in a competitive environment, which clearly is good for the firm and partnership as a whole, and maximizing profits per equity partner is a prudent strategy for accomplishing that goal. The partners who were expelled could never have

[270]No. CL-94-8646"AJ", 1996 WL 438777 (Fla. Cir. Ct. July 23, 1996), *aff'd in part, rev'd in part*, 728 So. 2d 253 (Fla. Dist. Ct. App. 1998).

[271]*Id.* at *7.

[272]*Id.*

[273]*See* Dalley, *supra* note 11, at 201 (stating that under the cost-of-contracting approach, "expulsion for the personal financial gain of the remaining partners will be a breach of the covenant of good faith").

[274]*Id.*

[275]*Id.* at 202.

[276]*See id.* at 201 (stating that "expulsion[s] in the best interests of the partnership" do not violate the duty of good faith and fair dealing) (internal quotation marks omitted)).

reasonably expected anything else. That is especially true given that the partnership agreement provides for guillotine expulsion.

Which side has the better argument here? That probably is a matter of perspective. The outcome under either the excluder or cost-of-contracting approach will likely depend on additional facts revealed in discovery. It is also possible that some of the expulsions will turn out to be lawful and others not.

Finally, with respect to economic self-interest, consider a case in which a senior partner is a major rainmaker at her firm. Over the years, she has institutionalized her clients by involving younger partners and associates in all aspects of their representations and by allowing them to interact directly with the clients' senior management. The other partners would like to redistribute the senior partner's generous compensation among others in the firm. On the theory that the firm will lose no clients if the senior partner leaves because other partners who are familiar to the clients from their representations will be able to retain the business, the firm expels the senior partner pursuant to the guillotine expulsion provision in the partnership agreement.

The senior partner's expulsion plainly violates the remaining partners' duty of good faith and fair dealing under the excluder approach. The firm expelled her for a predatory purpose. There was no suggestion that the senior partner was under-performing in any fashion; her colleagues simply coveted her share of the firm's profits. The expulsion also constitutes bad faith under cost-of-contracting analysis. The remaining partners are seeking to avoid a cost of their original agreement by keeping the senior partner's share of the firm's profits for themselves or for distribution to favored colleagues. The senior partner could not have reasonably expected that the firm would expel her for doing what all firms want all partners to do—develop new business and institutionalize the clients they attract so that those clients remain loyal to the firm even if the partner leaves, retires, or becomes disabled.

It is possible to conceive of other expulsions that would fail both the excluder and cost-of-contracting analyses. For example, expelling a partner for exercising rights granted by the firm's partnership agreement is clearly an act of bad faith under either approach.[277] Expelling a partner for honoring her obligations under rules of professional conduct should constitute bad faith no matter how analyzed.[278] A firm would also breach its duty of good faith and fair dealing no matter how analyzed if it expelled a partner as a result of another partner's personal vendetta, or because the target partner simply upsets or is disliked by more influential or powerful partners.

IV. CURRENT ISSUES

This Part examines two current issues. First, is the involuntary de-equitization of a partner a de facto expulsion of that partner? Second, if a firm vests all decision-

[277] *See, e.g.*, Winston & Strawn v. Nosal, 664 N.E.2d 239, 243-46 (Ill. App. Ct. 1996) (expelling partner who sought access to the firm's books and records).

[278] *See* Dalley, *supra* note 11, at 202 (asserting that such an expulsion should fail the cost-of-contracting test). *But see* Bohatch v. Butler & Binion, 977 S.W.3d 543, 545-47 (Tex. 1998) (finding that firm did not breach fiduciary duty when it expelled partner who reported colleague's possible fraudulent billing).

making authority in a single partner, including decisions concerning partner expulsion, does that in any fashion affect the duty of good faith and fair dealing?

A. De-Equitization and Expulsion

In the past several years, many of the nation's largest law firms have become two-tier or multi-tier partnerships, with both equity and non-equity partners.[279] (This Part will refer only to two-tier partnerships for simplicity's sake.) Two-tier partnerships allow law firms to state higher profits per partner, which are calculated solely on the basis of equity partners.[280] In theory, the higher a law firm's profits per partner, the greater its prestige and the greater its ability to attract superior legal talent.[281] The reasons for the rise of two-tier partnerships are perhaps best summarized as follows:

> In general, law firm consultants and managing partners . . . readily concede that the movement toward two-tier partnerships has been driven by economic factors. The perceived benefits of this structure fall roughly into four categories: (1) improved client service through lower lawyer attrition; (2) an elongated evaluation period that reduces errors in promotion to equity partner; (3) alignment of voting power with economic contribution, which reduces the likelihood of rainmaker defections; and (4) favorable market dynamics spawned by higher profits per partner, such as easier recruitment of lateral associates and partners and the ability to attract higher caliber law firms for potential mergers.[282]

For the most part, young lawyers ascending in law firms tend to placidly accept two-tier partnership, regardless of whether they expect to pass through a non-equity tier on their way to equity status or whether they anticipate remaining a non-equity partner indefinitely. For them, two-tier partnerships are a simple reality of modern law firm life. But non-equity partnership can also be employed as "a management tool to prune the partnership of unproductive equity [partners]."[283] During economic downturns, as well as during periods of flat profits or minimal growth, pressure builds within two-tier firms to demote equity partners who are perceived to be under-performing to non-equity status.[284] The process of demoting equity partners to non-equity status is referred to as "de-equitization."

For equity partners who are involuntarily de-equitized by their firms, the process—no matter how discreetly accomplished—is often embarrassing and

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[279]William D. Henderson, *An Empirical Study of Single-Tier Versus Two-Tier Partnerships in the* Am Law 200, 84 N.C. L. REV. 1691, 1694-95 (2006).

[280]A firm's profits per partner are calculated by dividing the firm's profits by the number of equity partners.

[281]Henderson, *supra* note 279, at 1694-95.

[282]*Id.* at 1711-12 (footnotes omitted).

[283]*Id.* at 1710.

[284]*See id.* (noting this phenomenon during economic downturns).

stigmatizing.[285] Being de-equitized is "almost like getting fired[.]"[286] It certainly is a bitter pill to swallow. But is de-equitization the equivalent of getting fired?[287] More accurately, is involuntarily de-equitizing a partner the same as expelling her?

There is some reason to think that involuntary de-equitization is de facto expulsion. "A partner without an equity interest is obviously a contradiction in terms."[288] Advocates for de-equitized partners might argue that law partnership is by definition an association of two or more individuals or professional corporations formed to practice law for profit,[289] and that definition does not accommodate lawyers who do not share in their firms' profits. Moreover, unlike equity partners, non-equity partners have little say in their firms' direction or management. Non-equity partners often do not participate in firm votes.[290] Judging by their scrutiny of billing rates, some sophisticated clients perceive non-equity partners as being fundamentally different from equity partners.[291] Last, because of indemnification provisions commonly found in two-tier firms' partnership agreements, non-equity partners are not personally liable for their firms' debts, and personal liability for the debts of one's firm is a distinguishing feature of partnership.[292] Thus, de-equitizing a partner is the same as expelling her.

The foregoing analysis, while superficially appealing, is overly simplistic. First, the fact that non-equity partnership is a contradiction in terms means only that partnership law has some catching up to do in the law firm realm.[293] It does not mean that a partner forced into non-equity status was expelled from her firm. Second, the definition of a partnership offered above does not require that all partners share in a firm's profits; it requires only that the firm be formed for the

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[285] *See* Jeff Blumenthal, *On the Distasteful Medicine of De-Equitization*, LEGAL INTELLIGENCER, Dec. 3, 2002, at 1 *available at* http://www.law.com/jsp/article.jsp?id=1038966824697 (quoting legal consultant Joel Rose).

[286] *Id.* (quoting legal consultant Joel Rose).

[287] An equity partner might voluntarily move to non-equity status because he prefers the reduced demands of non-equity status or because he is winding down his career. An equity partner might desire non-equity status because she no longer wants to invest capital in her firm, or because she favors the guaranteed income that non-equity status provides. Obviously, an equity partner's voluntary decision to move to non-equity status cannot be equated with expulsion.

[288] Hillman, *supra* note 12, at 397.

[289] *See* GREGORY, *supra* note 257, at 263 (defining a partnership [a]s "an association of two or more individuals, partnerships, corporations, or associations formed to carry on a trade, occupation, or profession for profit").

[290] Blumenthal, *supra* note 285, at 1 (quoting legal consultant Joel Rose).

[291] *See* Tamara Loomis, *Partner Status Is a Billing Issue: Firms Must Reveal Partner Status to Dupont when Asking for Fee Hike*, 27 NAT'L L.J., at 8, 8-9 (2005) (discussing DuPont's analysis and evaluation of billing rates between equity and non-equity partners).

[292] EEOC v. Sidley Austin Brown & Wood, 315 F.3d 696, 703 (7th Cir. 2002).

[293] *See* Hillman, *supra* note 12, at 397 ("The development of different levels of partner status within a [law] firm is one example of how the modern law firm has outgrown the law of partnerships.").

purpose of making a profit.[294] Anyway, most non-equity partners are compensated by way of guaranteed payments out of firm profits. Third, de-equitized partners remain partners to the outside world.[295] A de-equitized partner's business card still identifies her as a partner. Most law firm websites do not distinguish between equity and non-equity partners. Fourth, many law firms afford non-equity partners some voting rights. Some firms allow non-equity partners to vote on select issues, while others allow non-equity partners to vote on all matters on which equity partners vote. Even if they did not, that is often inconsequential. Under the centralized management model now common among large law firms, equity partners vote on relatively few issues.[296] Fifth, many law firms are now organized as limited liability partnerships, or LLPs, so the fact that non-equity partners are not personally responsible for firm debts is rarely a distinguishing feature.[297] Besides, the fact that non-equity partners are indemnified against personal liability does not mean that they do not have it, but rather that the equity partners in the firm will indemnify them if able. Finally, de-equitized partners keep their offices, remain among their colleagues, serve the same clients, and continue to be compensated for their work. In some cases, de-equitized partners' compensation does not materially decrease.

In short, it is difficult to conclude that de-equitizing a partner is generally akin to expelling her. There is authority, however, that might support a different result.

In *Davis v. Loftus*,[298] the plaintiffs sued Michael Loftus, David Engel, and the partners in the law firm of Gottlieb & Schwartz for Loftus' and Engel's alleged malpractice in a real estate transaction. One of the partners named as a defendant, Anthony Frink, moved for summary judgment on the basis that he did not qualify as a Gottlieb & Schwartz partner for vicarious liability purposes.[299] Frink was an "income partner."[300] According to the firm's partnership agreement, income partners received a fixed level of compensation set annually by the executive committee, plus a bonus. The partnership agreement expressly provided that income partners would not share in the firm's profits or losses. Each income partner made a $10,000 capital contribution to the firm to be repaid upon withdrawal or dissolution, without any

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[294] *But see* Community Capital Bank v. Fisher and Yanowtiz, 850 N.Y.S.2d 508, 510 (N.Y. App. Div. 2008) (requiring profit sharing for partnership).

[295] Loomis, *supra* note 291, at 9 (according to law firm consultant William Johnston, "[w]ho is and isn't an equity partner . . . is not something that is widely publicized externally [or] internally" (second alteration in original)).

[296] *See Sidley*, 315 F.3d at 699 (offering an extreme example of a law firm in which equity partners do not vote on most firm issues).

[297] *See generally* LARRY E. RIBSTEIN & PETER V. LETSOU, BUSINESS ASSOCIATIONS § 6.05, at 239 (4th ed. 2003) ("All LLP statutes provide that LLP partners are not personally liable for the negligence or other misconduct of other partners or employees unless the partner participated in or supervised the wrongdoing. . . . Most recently enacted LLP statutes limit the liability of LLP partners for both contract-type and tort-type liabilities.").

[298] 778 N.E.2d 1144 (Ill. App. Ct. 2002).

[299] *See id.* at 1148 (incorrectly characterizing the motion as a motion to dismiss).

[300] *Id.*

adjustment for firm growth or profits in the time since it was made. Income partners had no voting rights and were not eligible to sit on the executive committee.[301]

Several other income partners moved to join in Frink's motion. The trial court joined all of the income partners for consideration of Frink's motion.[302] The trial court granted the motion, holding that the "income partners did not qualify as partners, and therefore they did not share liability for the acts of [the firm's other] partners [or] employees . . . ."[303] The plaintiffs immediately appealed.

The court in *Davis* first noted that "[t]he substance and not the form of a business relationship determines whether the relationship qualifies as a partnership."[304] Here, the income partners received a fixed salary plus bonus and did not share in the firm's profits or losses; while they made capital contributions to the firm, the firm would repay those contributions in full upon the income partners' withdrawal from the firm or the firm's dissolution, regardless of the firm's profit or loss following the contribution; the firm's executive committee set income partners' compensation; and the income partners had no right to vote on the management of the firm or the conduct of its business.[305] The income partners at Gottlieb & Schwartz lacked "the essential characteristics of 'partners'" under the Illinois Partnership Act.[306] The court therefore found that they were not partners within the meaning of the Act and that they could not be held liable for Loftus' and Engel's alleged malpractice.[307]

Because Frink had presented the trial court with admissible evidence of his income partner status, the court affirmed summary judgment for him. The court also affirmed summary judgment for two other defendants identified as income partners in the partnership agreement that Frink submitted as an exhibit to his motion. The other income partners who had not been similarly identified saw their summary judgments reversed.[308] The *Davis* court remanded their cases to the trial court for the presentation of evidence concerning their partnership status.[309]

Davis indicates that, on the right facts, a court might not consider non-equity partners to be partners. If so, a firm's de-equitization of a partner is necessarily an expulsion. It is no help to distinguish *Davis* on the basis that it was not an expulsion case because it is not persuasive to argue that a lawyer can be a partner for some purposes but not others. Partnership is not a hat that a lawyer can take off and put on depending on the advantage to be gained or detriment to be avoided thereby.

In the end, it may not matter whether the involuntarily de-equitization of a partner is a de facto expulsion. This is because partners owe one another a duty of

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[301] *Id.*

[302] *Id.*

[303] Davis v. Loftus, 778 N.E.2d 1144, 1146 (Ill. App. Ct. 2002).

[304] *Id.* at 1151.

[305] *Id.* at 1152.

[306] *Id.* at 1153.

[307] *Id.* at 1152.

[308] Davis v. Loftus, 778 N.E.2d 1144, 1152 (Ill. App. Ct. 2002).

[309] *Id.* at 1152-53.

good faith and fair dealing "in all matters relating to the partnership business."[310] Because the duty of good faith and fair dealing is always in effect among and between partners in their roles as such, it must apply to de-equitizations just as it does expulsions. The decision to de-equitize a partner, if made in bad faith, is therefore actionable. Good faith and fair dealing in the de-equitization context can be evaluated under either of the methods used to evaluate the duty in relation to expulsions. Obviously, in the odd event that a firm's partnership agreement does not allow for de-equitization, a partner who is de-equitized may sue for breach of contract.

B. Good Faith and the Sole Decision-Maker

A few law firms grant their managing partners or chairpersons sole discretion to expel partners.[311] Such arrangements are rare,[312] but they do exist.[313]

Although there appear to be no reported cases on-point, it seems almost certain that vesting sole discretion in a managing partner or chairperson has the potential to complicate some expulsion matters. Managing partners are said to owe their co-partners "especially stringent" fiduciary duties equivalent to those owed by trustees to beneficiaries.[314] Or, as the court in *Welder v. Green*[315] phrased it, "[m]anaging partners owe their partners the highest fiduciary duty recognized in the law."[316] No matter how that exceedingly high duty is described or measured, it is surely true that it confers an advantage on ousted partners challenging their expulsions.

An expulsion ordered by a sole decision-maker is especially vulnerable to challenge where it is based not on the partner's alleged under-performance but on non-economic factors such as an alleged loss of trust in the expelled partner, the claimed existence of a schism in the firm attributable to the expelled partner's conduct, the alleged impairment of the firm's reputation as a result of the ousted partner's activities, and so on. In each of these instances the target partner is positioned to argue that the reason given for her expulsion is pretextual, that the decision was part of a personal vendetta, and that the managing partner is acting in bad faith. Although such allegations can be made in many cases, expulsions by committee or partnership vote are not judged by the elevated fiduciary standard

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[310]Winston & Strawn v. Nosal, 664 N.E.2d 239, 244-45 (Ill. App. Ct. 1996). *Accord* Bellino v. McGrath North Mullin & Kratz, PC LLO, 738 N.W.2d 434, 446 (Neb. 2007); Von Sternberg v. Caffee, 692 N.W.2d 549, 554 (S.D. 2005); Moore v. Moore, 599 S.E.2d 467, 472-73 (S.C. Ct. App. 2004).

[311]Nate Raymond, *The Terminator: Marc Kasowitz Has a Very Special Power*, AM. LAW., July 2008, at 33.

[312]*Id.*

[313]*See generally* Nate Raymond, *Former Partner's Lawsuit Against Kasowitz Benson Prompts Talk of One-Man Firing Machines*, AM. LAW., June 10, 2008, *available at* http://www.law.com/jsp/articlearticle.jsp?id=1202422064887 (discussing several firms' expulsion practices).

[314]Riddle v. Simmons, 922 So. 2d 1267, 1282 (La. Ct. App. 2006).

[315]985 S.W.2d 170 (Tex. App. 1998).

[316]*Id.* at 175.

applied to managing partners. In addition, expulsion by committee or partnership vote tends to inject objectivity into the process. Vesting discretion in an executive or management committee, or requiring a partnership vote to expel, may prevent potentially damaging misjudgments by a sole decision-maker. That is true regardless of the reasons offered for expulsion.

V. THE EMPLOYMENT LAW OVERPLAY

Our discussion so far has logically focused on partnership law. But many large and mid-sized law firms have embraced centralized management, with most decisions about firm affairs entrusted to executive or management committees.[317] Many decisions on which partners used to vote are now delegated to law firms' elected leadership. While managerial consolidation has many benefits for law firms, with those benefits comes the possibility that firms' personnel decisions involving partners are subject to federal anti-discrimination laws. This is because anti-discrimination statutes, such as Title VII of the Civil Rights Act of 1964 ("Tile VII"), the Age Discrimination in Employment Act ("ADEA"), and the Americans with Disabilities Act ("ADA"), protect "employees" against unlawful discrimination,[318] and partners in firms with centralized management may appear to be more like employees than partners. As a general rule, partners are considered to be employers, not employees, and thus are not protected under anti-discrimination laws.[319] Courts have typically been reluctant to extend anti-discrimination statutes "to the management of a law firm by its partners" given that "[t]he relationship among law partners" has been thought to "[differ] markedly" from employer-employee relationships.[320] This difference is manifested in "the common conduct of a shared enterprise[,]" which is "the essence of [a] law partnership."[321]

The effect of centralized management in professional partnerships is not lost on courts.[322] It is now foreseeable that partners in professional partnerships may be able to successfully challenge their demotion, discharge, or expulsion on the basis that those actions are discriminatory.[323] To prevail, a partner of course must show that she is an employee rather than an employer.[324] This can be a complex inquiry that is

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[317] *See* Rachel M. Milazzo, Note, *Circular Definitions of what Constitutes an Employee: Determining Whether the Partners of Sidley Austin Brown & Wood Qualify as Employers or Employees Under Federal Law*, 51 ST. LOUIS U. L.J. 1329, 1353 (2007) (noting this tendency with respect to the "majority of larger [law] firms").

[318] *Id.* at 1329-30.

[319] Simpson v. Ernst & Young, 100 F.3d 436, 443 (6th Cir. 1996) (discussing ADEA and ERISA as applied to a professional partnership).

[320] Hishon v. King & Spalding, 467 U.S. 69, 79 (1984) (Powell, J., concurring).

[321] *Id.* at 79.

[322] *See, e.g., Simpson*, 100 F.3d at 441-42 (discussing activities and responsibilities of accounting firm's management committee).

[323] *See, e.g., id.* at 440-44 (affirming judgment for accountant against firm on age discrimination and retaliation claims under ADEA and ERISA).

[324] EEOC v. Sidley Austin Brown & Wood, 315 F.3d 696, 702 (7th Cir. 2002).

not easily or expediently resolved.[325] As things now stand, six factors are relevant to this inquiry: (1) whether the firm can hire or fire the lawyer or set the rules and regulations governing her work; (2) whether and, if so, to what extent, the firm supervises the lawyer's work; (3) whether the lawyer reports to someone higher in the firm; (4) whether and, if so, to what extent, the lawyer is able to influence the firm; (5) whether the parties intended the lawyer to be an employee as expressed in written agreements or contracts; and (6) whether the lawyer shares in the profits, losses, and liabilities.[326] These factors are not exhaustive,[327] and no one of them is decisive.[328]

The possible application of anti-discrimination laws to law firm de-equitizations and expulsions has become a critical issue for all concerned as a result of the Seventh Circuit's decision in *EEOC v. Sidley Austin Brown & Wood*.[329] In 1999, Sidley & Austin, as the firm was then known, demoted thirty-two equity partners to "counsel" or "senior counsel" status.[330] None of the demoted partners filed a charge of discrimination against the firm.[331] The EEOC, however, launched an investigation to determine whether the firm's actions violated the ADEA.[332] The EEOC subpoenaed a variety of information from the firm to evaluate the ADEA's application and the existence of discrimination. For there to be an ADEA violation, "the [EEOC] would have to show that the 32 partners were [in fact] employees before their demotion[s]."[333] Sidley resisted the subpoena in part, so the EEOC applied to the district court for an order enforcing it in full. The district court ordered the firm to comply fully, and Sidley immediately appealed.[334]

The firm contended that the EEOC had no jurisdiction to investigate the demotions "because a partner is an employer within the meaning of the federal anti-discrimination laws if (a) h[er] income included a share of the firm's profits[;] (b) [s]he [contributed] capital [to] the firm[;] (c) [s]he [wa]s liable for the firm's debts[;] and (d) [s]he ha[s] some administrative or managerial [duties] . . . ."[335] The court's

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[325] *See, e.g.*, Panepucci v. Honigman Miller Schwartz & Cohn LLP, No. 05-2579, 2008 WL 2467979, at *3 (6th Cir. June 18, 2008) (noting that district court had denied law firm's motion to dismiss because it was unable to determine whether female partner alleging discrimination was an employee within the meaning of various federal laws).

[326] *See* Clackamas Gastroenterology Assocs. v. Wells, 538 U.S. 440, 449-50 (2003) (identifying the six factors which indicate whether a shareholder-director is an employee (quoting the EEOC Compliance Manual § 605:0009)).

[327] *Id.* at 450 n.10.

[328] *Id.* at 451.

[329] 315 F.3d 696 (7th Cir. 2002).

[330] *Id.* at 698.

[331] *Id.* at 701.

[332] *Id.* at 698.

[333] *Id.*

[334] *Sidley*, 315 F.3d at 699.

[335] *Id.*

focus, however, quickly shifted to the firm's highly centralized management structure. The record revealed the following:

> The firm [wa]s controlled by a self-perpetuating executive committee. Partners who [were] not members of the committee ha[d] some powers delegated to them by it with respect to the hiring, firing, promotion and compensation of their subordinates, but so far as their own status [wa]s concerned they [were] at the committee's mercy. It c[ould] fire them, promote them, demote them (as it did to the 32), raise their pay, lower their pay, and so forth. The only firm-wide issue on which [the] partners ha[d] voted in the last quarter century was the merger with Brown & Wood . . . . Each of the 32 partners at the time of their demotion . . . had a capital account with the firm, averaging about $400,000 . . . . [E]ach was liable for the firm's liabilities in proportion to his capital . . . . Their income, however, was determined by the number of percentage points of the firm's overall profits that the executive committee assigned to each of them. Each served on one or more of the firm's committees, but all these committees [were] subject to control by the executive committee.[336]

Sidley had satisfied Illinois law insofar as forming and maintaining a partnership went and the thirty-two demoted partners were partners for state law purposes.[337] The EEOC contended, however, that even if the demoted lawyers were partners under state law, that did not determine their status under federal anti-discrimination laws.[338] The question was whether Sidley partners were employers under the ADEA. The court was not satisfied that Sidley, by proving that the demoted lawyers were partners, had established that they were employers.[339] As the court explained in comparing the firm to a corporation:

> This case . . . involves a partnership of more than 500 partners in which all power resides in a small, unelected committee (it has 36 members). The partnership does not elect the members of the executive committee; the committee elects them, like the self-perpetuating board of trustees of a private university or other charitable foundation. It is true that the partners can commit the firm, for example by writing opinion letters; but employees of a corporation, when acting within the scope of their employment, regularly commit the corporation to contractual undertakings, not to mention . . . tort liability. Partners who are not members of the executive committee share in the profits of the firm; but many corporations base their employees' compensation in part . . . on the corporation's profits, without . . . supposing them employers. The participation of the 32 demoted partners in committees that have . . . merely administrative functions does not distinguish them from executive employees in corporations. Corporations have committees and the

[336] *Id.*

[337] *Id.* at 702.

[338] *Id.*

[339] *Sidley*, 315 F.3d at 702.

> members of the committees are employees; this does not make them employers. Nor are the members of the committees on which the 32 [serve] elected; they are appointed by the executive committee. The 32 owned some of the firm's capital, but executive-level employees often own stock in their corporations.[340]

The "most partneresque feature" of the demoted partners' relation to the firm was their personal liability for the firm's debts, because unlimited liability "is the most salient . . . difference between the standard partnership and a corporation."[341] But this factor was not sufficient to outweigh the other considerations. The fact that the thirty-two demoted partners were in fact partners did not determine whether they were employers, and their personal liability was germane only to the former.[342] It was possible that the two classes at issue—partners under state law and employers under federal law—did not overlap.[343]

Ultimately, the court concluded that the ADEA's potential application remained murky despite Sidley's partial compliance with the subpoena and that the EEOC was entitled to full compliance with the subpoena insofar as coverage was concerned.[344] The Seventh Circuit remanded the case to the district court with directions.[345]

Sidley ended with a bang, but not in the sense that a court finally determined whether the thirty-two demoted partners were actually entitled to protection under the ADEA. Rather, the case settled for $27.5 million.[346] Pursuant to the per capita distributions negotiated as part of the settlement, which were among the richest ever achieved by the EEOC, the payments to the thirty-two demoted partners averaged $859,375, with a high of $1,835,510 and a low of $122,169.[347] Under the consent decree entered into as part of the settlement, Sidley also admitted that it treated the thirty-two demoted partners as employees.[348] The firm did not admit that it violated the ADEA in demoting the partners.[349]

There can be no doubt that *Sidley* is an important case. The decision brightly signals the potential importance of federal, state and local employment law in de-equitization and expulsion matters. When firms consider adverse actions against

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[340] *Id.* at 702-03.

[341] *Id.* at 703.

[342] *Id.* at 704.

[343] *Id.*

[344] *Sidley*, 315 F.3d at 707.

[345] *Id.*

[346] Michael Bologna, *EEOC Reaches $27.5 Million Settlement In Age-Bias Action Against Sidley Austin*, 23 ABA/BNA L. MANUAL ON PROF. CONDUCT 533, 533 (2007); Ameet Sachdev, *Age Suit Could Raise Bar Sidley Austin Agrees to Pay $27.5 Million*, CHI. TRIB., Oct. 6, 2007, Business, at 1.

[347] Bologna, *supra* note 346, at 533.

[348] Press Release, EEOC, $27.5 Million Consent Decree Resolves EEOC Age Bias Suit Against Sidley Austin (Oct. 5, 2007), *available at* http://www.eeoc.gov/press/10-5-07.html.

[349] Sachdev, *supra* note 346, at 2.

partners, they now must consider the potential application of anti-discrimination laws to their decisions, in addition to the propriety of their actions under partnership law.[350] That said, it is critically important to observe that the court in *Sidley* did not rule that the demoted partners were employees under the ADEA; indeed, the court disclaimed such a ruling on the basis that it would be premature given the posture of the case.[351] Sidley's admission in settling that the demoted partners were employees for ADEA purposes is irrelevant to other controversies.

Furthermore, *Sidley* is distinguished by the extraordinary fashion in which the firm centralized its management. Most firms' executive committees are not self-perpetuating. Many firms have separate nominating committees that propose candidates for election to the executive or management committee, and then the firm elects one or more candidates from that slate. Nominating committee members are themselves elected by the partnership. Many firms have compensation committees that determine partners' compensation either independent of the executive or management committee or with only minimal involvement or oversight by the latter committee. Again, the partners elect the compensation committee members. Many law firms limit their management's ability to demote or expel partners. In most firms, apparently unlike Sidley, partners vote on the election of lawyers to partnership, rather than delegating that responsibility to the executive or management committee. In the twenty-five years leading up to the Seventh Circuit's decision, the Sidley partnership had voted on a single firm-wide issue. Few, if any, other law firms could make such a claim even if they wanted to. The list of ways in which another firm with centralized management might be distinguished from Sidley is long, and every one of those distinctions likely reduces the chance of anti-discrimination laws applying to de-equitization and expulsion decisions.

Finally, *Sidley* does not support the proposition that law firms may not de-equitize or expel partners without fouling anti-discrimination laws. Rather, the decision suggests that in some circumstances, employment law and partnership law may interact.[352]

VI. CONCLUSION

Law firm partners may be de-equitized or expelled by their firms in good times as well as lean. Such actions appear to be on the upswing. There are, however, relatively few cases on these subjects. The leading case, *Holman v. Coie*,[353] is dated; the practice of law, at least in large law firms, has changed considerably in the thirty plus years since *Holman* was decided. Looking ahead, courts must carefully reanalyze the intra-firm duty of good faith and fair dealing. Rather than confining liability to cases of economic predation, courts should review partner de-

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[350] *See, e.g.*, Panepucci v. Honigman Miller Schwartz & Cohn LLP, No. 05-2579, 2008 WL 2467979 (6th Cir. June 18, 2008) (detailing discrimination claims by female equity partner against law firm and ultimately affirming district court's determination that such claims were subject to arbitration clause in firm's partnership agreement).

[351] EEOC v. Sidley Austin Brown & Wood, 315 F.3d 696, 707 (7th Cir. 2002).

[352] *See, e.g.*, *Panepucci*, 2008 WL 2467979, at **2-6 (discussing effect of arbitration provision in partnership agreement on female equity partner's discrimination claims).

[353] 522 P.2d 515 (Wash. Ct. App. 1974).

equitizations and expulsions under either excluder or cost-of-contracting analysis. The fact that de-equitization and expulsion are not equivalents does not exempt the former from judicial scrutiny because partners' duty of good faith and fair dealing attaches to all matters relating to partnership business.

From firms' perspective, they must ensure that their de-equitization and expulsion decisions pass muster under both partnership and potentially anti-discrimination law. The discretion granted them by guillotine expulsion provisions in their partnership agreements, while generally allowing them to expel partners who are shirking or seriously disruptive, is not boundless, nor should it be.