

The Expulsion Clause in a Partnership Agreement: A Pre-Planned Dissolution

Partners are often hesitant to include an expulsion clause in their partnership agreement. This article explains the benefits of an expulsion clause and proposes that, in many cases, the attorney should encourage its inclusion. The article then suggests ways to insure that the clause is carefully drafted and suited to the needs of the parties.

INTRODUCTION

Expulsion clauses are rarely included in a partnership agreement despite their advantages.¹ The use of an expulsion clause facilitates exclusion of an unwanted partner and stipulates, in advance, its financial consequences. At the formation stage of a business, potential partners are generally reluctant to consider the possibility of expelling an associate. This hesitancy, along with the optimism accompanying the start of a business, may have the unfortunate consequence of deterring the parties from discussing the advantages of an expulsion clause. In addition, a partner may fear that the others may take advantage of him or her should expulsion occur.² However, expulsion may be necessary for various reasons, including declining business due to internal dissension.³ As a result, it is the attorney's responsibility

¹ Bromberg, *Partnership Dissolution—Causes, Consequences, and Cures*, 43 *TEX. L. REV.* 631, 653 (1965).

² "Expulsion provisions are rare because of each partner's fear that the others may gang up on him. However, if properly limited, they are useful, especially for professional firms which might be disqualified by the actions of a member." A. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP 426 (1968).

³ See London, *Managing Your Practice: Working with an Incompatible Partner*, 11 *PRAC. ACCOUNTANT* 45-46 (1978), for an explanation of possible causes of incompatibility, such as the pressures of partnership responsibility or unrealized income expectations. London emphasizes the need for pre-planning of a potential split-up to lessen damaging consequences. See also F. O'NEAL & J. DERWIN, *EXPULSION OR OPPRESSION OF BUSINESS ASSOCIATES* 11-40, (1961).

to broach the subject of expulsion⁴ and, if the parties are reluctant to discuss it, to suggest ways to make the expulsion clause more palatable.⁵

The absence of an expulsion clause may have serious consequences for the partners.⁶ Without such a clause, partners must resort to other methods to exclude an incompatible partner.⁷ For example, the partners may have to dissolve the business and liquidate the assets to exclude the partner. Use of such methods may breach the fiduciary duty owed to one's partner.⁸ The ensuing litigation will draw the partners away from the operation of the business and may cause the ongoing business to suffer economic loss.⁹ If the business relationship breaks down, the parties

Discussing the corporate form, the authors explain sources of dissension, some of which would also apply to partnerships. Included are greed or desire for more power by one partner, the presence of an inactive partner, the drive of a superior talent to assume total managerial control, or tension caused by an unreasonable or uncooperative associate.

⁴ To avoid a potential conflict of interest, the attorney should suggest that the partners each seek independent counsel prior to signing the partnership agreement. ABA CANONS OF PROFESSIONAL RESPONSIBILITY, Ethical Consideration 5-16.

⁵ Two alternatives less dramatic than an expulsion clause are an extended training period or a prior evaluation process for new partners. While useful, these methods would not insure that problems would not arise subsequent to conferring partnership status. See Scholl, *Managing Your Practice: How to Prevent a Problem Partner* 12 PRAC. ACCOUNTANT 17-18 (1979), for a discussion endorsing the use of these alternative methods.

⁶ See Brill, *After the Fall*, ESQUIRE, Mar. 13, 1979, at 15 where the author reports on the firing of five partners of a New York law firm following the loss of a major client. In the absence of a partnership agreement or an expulsion clause, heated arguments resulted for several months over when the fired partners would leave and what they would draw as severance. *Id.*

⁷ O'Neal and Derwin describe partnership practices employed by a strong majority to coerce minority partners to cooperate. They include exclusion from management meetings, denial of access to the books and records, and lockout from the office. F. O'NEAL & J. DERWIN, *supra* note 3, at 146-67.

⁸ "Every partner must account to the partnership for any benefit, and hold as trustee for it any profits, derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property." UNIFORM PARTNERSHIP ACT § 21, reprinted in 6 UNIFORM LAWS ANNOTATED 258 (Master Ed. 1979) [hereinafter cited as U.P.A.]; CAL. CORP. CODE § 15021 (West 1977). See note 81 *infra*. See also Note, *Fiduciary Duties of Partners*, 48 IOWA L. REV. 902 (1963).

⁹ "The dissolution of a partnership through the courts is a costly and troublesome proceeding, and should be resorted to only when it is found to be im-

will therefore benefit from a pre-planned or liquidated expulsion.¹⁰

This comment analyzes the need for an expulsion clause in partnership agreements. It then discusses the key elements of a carefully drafted expulsion clause. The comment concludes that expulsion clauses will minimize the detrimental effects of a partner's expulsion; therefore, such a clause may be vital to protect the parties' interests.¹¹

I. BENEFITS OF AN EXPULSION CLAUSE

An expulsion clause provides important advantages in a partnership's daily operation in addition to facilitating the expulsion of an unwanted partner. The mere existence of an expulsion clause promotes cooperation among the associates. It also serves as a safeguard in preventing the exclusion of a partner by illegal means,¹² avoiding the dangers of a dissolution at will, and preserving the continuity of the ongoing partnership.

Before an expulsion clause's benefits can be enjoyed, however, the parties must include an express expulsion provision in the partnership agreement.¹³ There is no common law or statutory

possible to settle differences peaceably. . . ." T. CONYNGTON, A MANUAL OF PARTNERSHIP RELATIONS 119 (1905).

¹⁰ See note 26 *infra* for a discussion of the analogy between an expulsion clause and a liquidated damages provision. See also BLACK'S LAW DICTIONARY 522 (5th ed. 1979) which defines expulsion as: "The act of depriving a member of a corporation, legislative body, assembly, society, commercial organization, etc., of his membership in the same, by a legal vote of the body itself." In *Willman v. Beheler*, 499 S.W.2d 770, 776 (Mo. 1973), the Supreme Court of Missouri recognized the right of either party in a two-person partnership to bring about termination of the partnership by agreement. As an equivalent to expulsion, the unconditional right to terminate the partnership was governed by terms in the agreement providing for termination without cause, a 30-day notice, and fixed financial consequences. These components are similarly found in partnership expulsion clauses.

¹¹ Because of the variety and flexibility of expulsion clauses, it is impracticable to discuss specific types of partnerships and their individual needs within the scope of this comment. This comment focuses on the broader principles behind drafting decisions rather than on precise wording of such clauses.

¹² See notes 18-21 and accompanying text *infra*.

¹³ "Dissolution is caused without violation of the agreement between the partners, by the expulsion of any partner from the business bona fide in accordance with such a power conferred by the agreement between the partners." U.P.A. § 31(1)(d); CAL. CORP. CODE § 15031(1)(d) (West 1977).

right to expel a partner from a partnership.¹⁴ The UNIFORM PARTNERSHIP ACT¹⁵ exclusively controls the availability of expulsion as a remedy for dissension within a partnership.¹⁶ Without an expulsion clause, the parties must resort to other measures to exclude a partner, such as dissolution in contravention of the agreement.¹⁷ Such an expulsion deprives the parties of the benefits of a prior agreement.

The partnership stands to benefit from an expulsion clause because it promotes cooperation among the partners. When the clause makes expulsion accessible, there is pressure among the partners to cooperate rather than risk their membership in the association. The partnership agreement can facilitate expulsion, for example, by allowing it for any reason, by majority vote and by making the financial consequences explicit. Facility of expulsion has the coercive effect of suppressing disharmony.

An expulsion clause also prevents exclusion of a partner by illegal means.¹⁸ The fiduciary duties owed to one's partners and the consensual nature of the relationship preclude partners from utilizing methods of exclusion legally available under other business forms.¹⁹ An attempted exclusion which violates these duties may lead to costly litigation, resulting in sanctions against the

¹⁴ See *Millet v. Slocum*, 4 A.D.2d 528, 167 N.Y.S.2d 136 (1957), *aff'd*, 5 N.Y.2d 734, 177 N.Y.S.2d 716 (1958); and *Haynes v. Allen*, 482 S.W.2d 85 (Mo. App. Ct. 1972).

¹⁵ The UNIFORM PARTNERSHIP ACT has been enacted with only minor revisions in 48 states. The only states that have not adopted the U.P.A. are Georgia and Louisiana. 6 UNIFORM LAWS ANN. 7 (Master Ed. Supp. 1978) (Table). In California, the act is codified in CAL. CORP. CODE §§ 15001-45 (West 1977).

¹⁶ U.P.A. § 31(1)(d); CAL. CORP. CODE § 15031(1)(d) (West 1977), set forth in note 13 *supra*.

¹⁷ U.P.A. § 31(2); CAL. CORP. CODE § 15031(2) (West 1977), set forth in note 24 *infra*.

¹⁸ Such illegal means are exemplified in cases where the expelled partner pursues a determination of a wrongful dissolution and seeks damages against the excluding partners. In *Niles v. Leitman*, 278 A.D. 330, 104 N.Y.S.2d 822 (1951), one partner was excluded from the office. In *Dow v. Beals*, 149 Misc. 631, 268 N.Y.S. 425 (1933), the wronged partner was excluded from management of the partnership business.

¹⁹ O'Neal and Derwin explain the corporate squeeze-techniques which are unavailable under the partnership form, such as terminating employment, withholding dividends, manipulating shareholder's or director's meetings, and issuance of new stock to dilute minority interests or voting power. F. O'NEAL & J. DERWIN, *supra* note 3, at 143-44.

excluding members,²⁰ court-ordered dissolution of the partnership, and an accounting.²¹ An expulsion clause sets out specific standards for a justifiable exclusion and avoids the legal turmoil which results when frustrated partners must resort to other means to expel an unwanted partner.

The partners can also decrease the dangers of a dissolution at will pursuant to U.P.A. § 31²² by use of an expulsion clause. According to the U.P.A., any partner has the power to dissolve the business at any time for any reason.²³ However, dissolution under U.P.A. § 31 may be deemed wrongful.²⁴ Consequently, the expelling partners may become liable to the expellee for damages or forfeit the right to continue the business.²⁵ However,

²⁰ See *Page v. Page*, 55 Cal. 2d 192, 359 P.2d 41, 10 Cal. Rptr. 643 (1961) where the court assessed damages against the wrongful partner who excluded his partner from anticipated profits by dissolving the firm prematurely. Similarly, in *Gardner v. Shreve*, 89 Cal. App. 2d 804, 202 P.2d 322 (1st Dist. 1949), the court ruled that the wrongful partner who caused the dissolution owed damages to his co-partner and had forfeited his share of goodwill.

²¹ Should operation of the business become untenable because of a partner's misconduct or his or her breach of the partnership agreement, the court shall decree a dissolution. U.P.A. § 32(1); CAL. CORP. CODE § 15032(1) (West 1977). See *Stark v. Reingold*, 18 N.J. 251, 113 A.2d 679 (1955), where the court ordered dissolution, liquidation, and distribution of assets when both members of the partnership violated fiduciary duties owed one another.

²² Cf. U.P.A. § 31(1)(b) and § 31(1)(c) which provide for dissolution at will: Dissolution is caused: [w]ithout violation of the agreement between the partners, (b) by the express will of any partner when no definite term or undertaking is specified, (c) by the express will of all the partners who have not assigned their interests or suffered them to be charged for their separate debts, either before or after termination of any specified term or particular undertaking. U.P.A. § 31(1)(b) & (c); CAL. CORP. CODE § 15031(1)(b) & (c) (West 1977).

²³ "The relation of partners is one of agency. The agency is such a personal one that equity cannot enforce it even where the agreement provides that the partnership shall continue for a specified time. The power of any partner to terminate the relation, even though in doing so he breaks a contract should, it is submitted, be recognized." Official Comment, U.P.A. § 31.

²⁴ "Dissolution is caused in contravention of the agreement between the parties, where the circumstances do not permit a dissolution under any other provisions of this section, by the express will of any partner at any time." U.P.A. § 31(2); CAL. CORP. CODE § 15031(2) (West 1977). "This does not mean, of course, that a partner has the *right* to dissolve the partnership by his unilateral act in contravention of the agreement between the partners; it means he has the *power* to do so, subject to sanctions for wrongful dissolution." 48 CAL. JR. 3d *Partnership* § 73 (1979) (emphasis added).

²⁵ See note 20 *supra*.

where the expelling partners act pursuant to an expulsion clause in the partnership agreement, the danger that a court would find the expulsion wrongful is considerably lessened.

Finally, an expulsion clause preserves the continuity of the ongoing partnership by minimizing judicial interference should expulsion occur. Where the partners find one of their colleagues so incompatible that the effectiveness of the business is threatened, his or her exclusion is warranted. At this juncture, all parties benefit from an expulsion clause as it provides for a liquidated dissolution, pre-arranging the buy-out of the expelled partner.²⁶ Because a proper expulsion clause regulates the rights of all parties, a court need only resolve procedural disputes,²⁷ and a limited range of factual issues.²⁸ Otherwise, the court merely ratifies the partners' agreement.²⁹ Thus, the expulsion clause narrows the issues a court may resolve.

An expulsion clause provides substantial benefits to the partnership. These benefits will be lost, however, if the clause is not carefully drafted. An expulsion clause is comprised of a number of components which the drafting attorney can manipulate to meet the partners' needs.

II. PROVISIONS TO IMPLEMENT EXPULSION

An expulsion clause should be tailored to meet the needs of the parties and to suit the nature of the business. The agree-

²⁶ The process of expulsion may be analogized to a liquidated damages provision in a contract. If the parties accept the agreement's terms regarding the buy-out, courts will give effect to those terms in the absence of overreaching or fraud. See *Fortugno v. Hudson Manure Co.*, 51 N.J. 482, 144 A.2d 207 (1958) (the express written agreement was held to determine the rights of the parties in a dissolution of a family partnership); *Riviera Congress Associates v. Yassky*, 18 N.Y.2d 540, 277 N.Y.S.2d 386, 223 N.E.2d 876 (1966) (self-dealing per se is not a violation of fiduciary concepts when the partnership agreement expressly fixes the rights of the parties).

²⁷ For example, a procedural dispute might arise concerning the mechanics of the vote for expulsion, the adequacy of the notice to the expellee, or the correctness of financial calculations. See text accompanying note 78 *infra*.

²⁸ If the expulsion is for cause, there may be a factual dispute as to the expelled partner's wrongdoing. See text accompanying notes 82-84 *infra*.

²⁹ The court in *Lyon v. Sanger*, 107 N.Y.S.2d 300 (1951), upheld an expulsion pursuant to the agreement in a declaratory action brought by the expelling partners. They sought judicial assistance in settling a dispute over the financial consequences of the expulsion. The court appointed a referee to accomplish this settlement.

ment must include a provision granting the right to expel. The first critical determination regarding the clause itself is whether to provide for expulsion without cause or for cause. This choice impacts upon the clause's other elements. It affects the key provision specifying financial consequences of expulsion. It also affects the procedural requirements such as notice to the expellee and the number of votes needed for expulsion.³⁰ The clause should grant the right to continue the business to the expelling partners and provide for the indemnification of the expellee. The parties may want to include complementary provisions in the partnership agreement, such as a covenant not to compete or an arbitration clause. These provisions will vary the impact of the expulsion clause on the partnership. By manipulating both the fundamental elements and related provisions, the attorney can construct a clause as flexible or as structured as the parties desire.

A. Provisions of the Expulsion Clause

The threshold decision the parties must make is whether to provide for expulsion without cause or for cause.³¹ A clause which allows expulsion without cause simply requires approval of expulsion by a fixed percentage³² of the expelling partners.³³ In contrast, a provision for expulsion for cause generally lists the circumstances under which the remedy is available as well as the voting requirements.³⁴ If potential associates express great reluc-

³⁰ See M. VOLZ & A. BERGER, *THE DRAFTING OF PARTNERSHIP AGREEMENTS* 16-17 (1976), for a discussion of the provisions of an expulsion clause.

³¹ *Id.* at 95-96.

³² See notes 53-57 and accompanying text *infra*.

³³ Partners may agree to a clause authorizing a majority to expel a partner without cause, such as:

A majority in interest of the partners may at any time require any partner to retire from the partnership by delivering to him a notice in writing six (6) months prior to the effective date for his retirement. As of such effective date settlement shall be made with him by the firm for all his interest in the partnership, including its goodwill and name, in the manner hereinafter set forth.

M. VOLZ AND A. BERGER, *supra* note 30, at 96.

³⁴ One example of a standardized clause is:

A partner may be expelled from the partnership by the vote of the other partners holding at least _% in capital of the interest of the partnership (excluding the interest of the partner to be expelled) if, by this vote, it is determined in the sole discretion of those part-

tance to grant their partners the power to expel, a clause which is inclusive and enumerates only acts of severe misconduct may be appropriate. At the other extreme, if the uninterrupted continuation of the partnership is the paramount concern, a clause which provides for expedient expulsion without determining cause would be more suitable. In a given case, the attorney will have to balance the parties' interests in proposing a clause without cause or for cause.

If the parties opt for expulsion for cause, the clause should list the causes justifying expulsion.³⁵ Possible grounds for expulsion include personal incompatibility, inactivity, disability, neglect of business, immorality, professional misconduct, breach of the partnership articles, and conflicting outside interests.³⁶ A listing of grounds for a partner's expulsion may be inclusive or merely illustrative depending upon the parties' desire to restrict the circumstances under which expulsion may occur.³⁷

The terms stipulating financial consequences of expulsion are determined in part by whether the clause allows expulsion without cause or for cause. If a partner may be expelled without cause, the partners may find the clause unacceptable unless the buy-out of the expellee is generous.³⁸ If the buy-out is not generous, the risk imposed by the ease of expulsion is not outweighed by the marginal benefit accruing from expulsion. Conversely, where the clause provides for expulsion for cause, a return of an associate's capital contribution might be sufficient.³⁹ The ex-

ners that the partner to be expelled has materially breached or is unable to perform his material obligations under this agreement or that the continued association of that partner with the partnership is detrimental to the best interest of the partnership's business.

C. KARPLUS, *ADVISING CALIFORNIA PARTNERSHIPS* 103 (1975).

³⁵ J. CRANE, *HANDBOOK ON THE LAW OF PARTNERSHIP* 400 (1952).

³⁶ M. VOLZ & A. BERGER, *supra* note 30, at 95.

³⁷ In a professional partnership, the grounds for expulsion could include misconduct, suspension or revocation of a right to practice, or conviction of a felony or crime involving moral turpitude. C. KARPLUS, *supra* note 34, at 104.

³⁸ An example of a generous buy-out is where the agreement treats the expelled partner as a retired partner, providing for some percentage of future profits. However, the partners may wish to grant only a return of capital and undistributed earnings of prior and current fiscal years. This alternative may be viewed as generous as a return to an expelled partner. Boughner, *Partnership Agreements*, 42 ILL. BAR J. 602, 609 (1954).

³⁹ The expelled partner would be deprived of any value of goodwill. See text accompanying notes 46-48 *infra*.

pelled partner, by committing a wrong specified in the expulsion clause, would forego the more generous treatment afforded a retiring partner. In either case, in the absence of coercive factors motivating a partner to accept an expulsion clause,⁴⁰ the cause provisions will affect the financial consequences of expulsion.

As a practical matter, the financial consequences of expulsion may ultimately determine whether all parties will accept the clause.⁴¹ This section may include provisions for the return of a partner's capital contribution, formulas for determining a partner's share of the goodwill,⁴² and provisions for payment of the expellee's share of the earned profits. A minimum buy-out would at least provide for the return of a partner's capital contribution⁴³ to avoid a forfeiture of investment.⁴⁴ In order to make the

⁴⁰ For instance, a new partner entering an existing large partnership might find it necessary, after weighing the advantages of membership, to accept financial terms for the buy-out following expulsion which, under other circumstances, would be unacceptable. A dissenting minority partner in a large firm would face similar coercion should a large majority favor a stringent expulsion clause.

⁴¹ Valuation of the expelled partner's interest should be as clearly defined as possible, either by stating an amount to be paid or by establishing a formula. Bromberg, *supra* note 1.

⁴² Goodwill is defined as a "well-founded expectation of continued public patronage." H. REUSCHLEIN & W. GREGORY, *HANDBOOK ON THE LAW OF AGENCY AND PARTNERSHIP* 336 (1979) (citations omitted). It is the value of the business beyond its assets which the business receives "from constant or habitual customers on account of its local position or common celebrity." *Id.* (citations omitted). Although goodwill is an intangible, it is, in absence of contrary agreement, part of the property and assets of the partnership. *Id.* at 336-37 (citations omitted).

⁴³ In *Lyon v. Sanger*, 107 N.Y.S.2d 300 (1951), the court upheld an expulsion carried out pursuant to a unanimous vote with no requirement of cause. The remaining partners brought the action to declare that the expelled partner was no longer a member of the partnership. The expulsion clause returned the expelled partner's contribution and his share of undistributed profits. The court dismissed his counterclaim for a share of the net worth of the business. A referee was appointed to take an accounting and determine if calculation of his share of the profits was accurate. *Cf.* with *Frank v. R. A. Pickens & Son Co.*, 572 S.W.2d 133 (Ark. 1978), where the court upheld the use of book value as the measuring device. The agreement provided for the repayment of the expelled partner's respective share of the book value of the partnership as of December 31st of the year preceding the expulsion, plus ten percent of the amount accrued as of the date of expulsion as interest. However, "[b]ook value is commonly used, as a standard of valuation, but even if the books are kept up to date by a knowledgeable accountant, book value in itself may be unfair." H. REUSCHLEIN & W. GREGORY, *supra* note 42, at 464-65. The major disadvantages

clause acceptable to the parties, the attorney must insure that these provisions are reasonable.⁴⁵

Several factors influence the availability of goodwill to the expelled party as well as affect goodwill valuation.⁴⁶ For example, repayment of goodwill may depend on whether expulsion is without or for cause, and on the degree of fault at issue. Where expulsion is without cause and there is no element of wrongfulness involved, the expelled partner is likely to be entitled to goodwill. However, if expulsion is for cause, the expelled partner could be denied any value of goodwill. Goodwill is an intangible not easily valued; therefore, a rough estimate is usually determined by use of a formula.⁴⁷ One such formula values a partner's share of the goodwill by determining first his or her share of assets, then subtracting this figure from the partner's share of capitalized earnings.⁴⁸ Because such methods are often imprecise, however, other interests may be substituted as compensation for goodwill.

As a substitute for goodwill, the agreement could provide for a share of anticipated profits from the continuing partnership for a limited time.⁴⁹ The expelled partner may, in addition, be entitled to his or her share of profits earned as of the date of expulsion.⁵⁰ Whatever method of valuing a partner's interest in the

of book value noted are that it usually reflects conservative accounting, is not the fair market value and excludes consideration of goodwill. *Id.*

⁴⁴ One rather drastic approach involves returning nothing to a partner expelled for cause and allowing the firm "as a matter of grace, [to] make payments to the expelled partner on what they consider an equitable basis." P. CARRINGTON & W. SUTHERLAND, *ARTICLES OF PARTNERSHIP FOR LAW FIRMS*, 6 *ECONOMICS OF LAW PRACTICE SERIES* 79 (1961-62).

⁴⁵ The valuation method for expulsion could be the same as for a voluntary withdrawal. The troublesome partner will then be more likely to withdraw rather than become a source of dissension, necessitating expulsion. F. O'NEAL & J. DERWIN, *supra* note 3, at 190.

⁴⁶ M. VOLZ & A. BERGER, *supra* note 30, at 117.

⁴⁷ *Id.* at 117-19.

⁴⁸ H. REUSCHLEIN & W. GREGORY, *supra* note 42, at 467.

⁴⁹ Since one means of valuation of goodwill is to deduct asset value from capitalized earnings, a major element of goodwill is the present, discounted value of the future stream of income. *See id.*

⁵⁰ *See Lyon v. Sanger*, 107 N.Y.S.2d 300 (1951), discussed in notes 29 & 43 *supra*. *See also Bailey v. Jackson*, 573 S.W.2d 267 (Tex. Civ. App. 1978), where the court applied the Texas-enacted U.P.A. § 42 to an expulsion situation, granting rights to the expelled partner similar to rights granted to a deceased partner's estate or to a retired partner. The court substituted the words "ex-

business is chosen, it should be specifically included in the agreement to provide certainty to the financial consequences of expulsion.

Whether an expulsion clause provides for expulsion for or without cause, the clause should include some provision for reasonable notice to the expelled partner.⁵¹ Reasonable notice will allow the partner to wind up his or her ongoing business and help provide a less disruptive exit. Where there is an element of wrongfulness involved, as when the expulsion is for cause, the time specified in the notice provision may be minimal. On the other hand, the partnership agreement may provide for the possibility of an opportunity to rebut the charges where the partner is expelled for cause.⁵² If so, notice should be lengthy enough to allow the partner to prepare a rebuttal. In either case, the provision should give the expelled partner adequate time to relocate.

Another procedural protection for the parties involves fixing the percentage of votes required to expel a partner, whether the clause provides for expulsion for or without cause.⁵³ Several factors are significant in making this determination. If the firm is small, the partners may want a unanimous vote, excluding the vote of the partner to be expelled.⁵⁴ A larger partnership might agree that eighty or ninety percent represents a sufficient con-

pelled partner" with "retired partner" or "estate of deceased partner" in the statute, noting that the code provides for a different arrangement by agreement. In this case, there was no contrary agreement. Thus, the expelled partner received his share of profits earned to the date of expulsion. See U.P.A. § 42.

⁵¹ M. VOLZ & A. BERGER, *supra* note 30, at 96.

⁵² C. DRAKE, *LAW OF PARTNERSHIP* 101 (1977).

⁵³ The clause may provide for different voting requirements where the various methods of expulsion are combined in one clause. If no cause is required to be determined, then a near-unanimous vote would be appropriate, whereas if a cause determination is provided, the percentage could be lessened. Such a clause might read:

A Partner may at any time be expelled by the vote of three-fourths of the Partners for: (A) Professional misconduct or disqualification, (B) Willful or persistent breach of this Agreement, or (C) Conduct which tends to affect prejudicially the carrying on of the Partnership affairs.

A partner may at any time be expelled, with or without cause, by unanimous vote of the other Partners.

A. BROMBERG, *supra* note 2, at 611.

⁵⁴ The clause should expressly state that the partner to be expelled is not entitled to vote on the expulsion issue. C. KARPLUS, *supra* note 34.

sensus. If the parties are somewhat reluctant to accept the inclusion of an expulsion clause, a near unanimous voting requirement might mitigate this hesitancy.⁵⁵ A near-unanimous vote would also be appropriate for a without cause expulsion clause because of the severity of the sanction.⁵⁶ A high percentage requirement will help to protect a partner from arbitrary expulsion.⁵⁷ If expulsion is for cause, a lesser voting requirement might be appropriate. The process of cause determination would tend to protect the partners from an ill-founded expulsion. Thus, the voting requirement is closely tied to the without or for cause decision.

The clause should include two provisions to protect both the remaining partners and the expelled partners following expulsion.⁵⁸ The right of the remaining partners to continue the business is implied in the concept of expulsion.⁵⁹ The agreement, however, should make this right explicit.⁶⁰ When the business is continued, the remaining partners should assume the expelled partner's share of liability to creditors.⁶¹ This is accomplished by

⁵⁵ The requirement for a unanimous or relatively large percentage vote would offer some protection against using an expulsion clause to freeze-out a minority partner. *Id.*

⁵⁶ See Comment, *Drafting Problems of Partnership Agreements*, 40 CALIF. L. REV. 67, 80 (1952).

⁵⁷ See F. O'NEAL & J. DERWIN, *supra* note 3, at 190. *Cf.* Frank v. R. A. Pickens & Son Co., 572 S.W.2d 133 (Ark. 1978). In Frank, the Arkansas Supreme Court upheld a partnership agreement which allowed the single vote of the managing partner of a twenty-two member farming partnership to have exclusive control over the admission and expulsion of all other partners. The court denied the expelled partner's request to liquidate the partnership assets by forcing a sale, holding that the terms of the agreement were controlling.

⁵⁸ Unless an agreement specifies the rights of the parties, the partners and the expelled member will be treated as if the expelled partner had died. H. REUSCHLEIN & W. GREGORY, *supra* note 42, at 347.

⁵⁹ Bromberg, *supra* note 1.

⁶⁰ The following is an example of a clause providing for no dissolution upon withdrawal of a partner: "In particular, the partnership shall not be dissolved by . . . [t]he withdrawal of a Partner (defined to mean expulsion, retirement, death, disability or bankruptcy of a Partner)." A. BROMBERG, *supra* note 2, at 610.

⁶¹ U.P.A. § 41(6); CAL. CORP. CODE § 15041(6) (West 1977): "When a partner is expelled and the remaining partners continue the business either alone or with others, without liquidation of the partnership affairs, creditors of the dissolved partnership are also creditors of the person or partnership continuing the business." *Id.*

providing for indemnification of the outgoing partner or by including an agreement pursuant to U.P.A. § 36(2) discharging the outgoing partner from existing liability.⁶² The expellee under U.P.A. § 38(1) is then entitled only to the net amount due him or her from the partnership under the agreement's terms.⁶³ Additionally, the continuing partners do not risk application of partnership property to discharge that partner's personal liabilities.⁶⁴

An expulsion clause has several components, all of which combine to make it effective. The initial determination concerns whether to expel for or without cause. This decision influences the remaining provisions for financial return, notice and voting requirements. These elements of the expulsion clause are necessary for a complete disposition of the rights of all parties.

B. Complementary Provisions

In addition to the foregoing integral components of an expulsion clause, a covenant not to compete and an arbitration clause may also be included with an expulsion clause to vary its impact. These provisions are significant because they will increase the expulsion clause's effectiveness and minimize the potential for litigation based upon an expulsion. A covenant not to compete⁶⁵ will make the expulsion clause more effective because it will prevent an expelled partner from setting up his or her own business in the vicinity of the continuing partnership, drawing away business.⁶⁶ An arbitration clause will minimize litigation by narrow-

⁶² U.P.A. § 36(2); CAL. CORP. CODE § 15036(2) (West 1977): "A partner is discharged from any existing liability upon dissolution of the partnership by an agreement to that effect between himself, the partnership creditors and the person or partnership continuing the business. . . ." *Id.*

⁶³ U.P.A. § 38(1); CAL. CORP. CODE § 15038(1) (West 1977): "[I]f dissolution is caused by expulsion of a partner, bona fide under the agreement and if the expelled partner is discharged from all partnership liabilities, either by payment or agreement under Section 36(2), he shall receive in cash only the net amount due him from the partnership." *Id.*

⁶⁴ See Bromberg, *supra* note 1, at 652, noting that the expelled partner has no liquidation right.

⁶⁵ When an agreement contains an expulsion clause, it is usually necessary for the agreement to include a non-competition covenant. H. REUSCHLEIN & W. GREGORY, *supra* note 42, at 468.

⁶⁶ The threat would be especially great in a small town or where a partner's personal or professional reputation might draw clientele away from the continuing business.

ing the range of issues the court may address. When the parties have accepted an expulsion clause in their partnership agreement, the attorney should explain the consequences of both clauses, and suggest that they be included.

A covenant not to compete insures that the expulsion clause will not result in harm to the continuing partnership.⁶⁷ The purpose of a covenant not to compete is to preclude the outgoing partner from engaging in any business similar to the continuing partnership within a given geographical area for a stated time.⁶⁸ The effect of expulsion when coupled with a covenant not to compete is two-fold. First, the goodwill of the continuing business is preserved,⁶⁹ and second, the adverse impact on the expelled increases. Such a covenant may be indispensable to the effectiveness of an expulsion clause because an expelled partner

⁶⁷ CAL. BUS. & PROF. CODE § 16602 (West 1964) authorizes non-competition covenants:

Any partner may, upon or in anticipation of a dissolution of the partnership, agree that he will not carry on a similar business within a specified county or counties, city or cities, or a part thereof, where the partnership business has been transacted, so long as any member of the partnership, or any person deriving title to the business or its goodwill from any such other member of the partnership, carries on a like business therein.

This statute defines a partner's ability to so covenant in terms of specified geographical distances from the continuing partnership, modifying the general terms of Section 16600 which prohibits a total restraint on engaging in a lawful profession, trade or business. But see ABA CANONS OF PROFESSIONAL RESPONSIBILITY, Ethical Consideration 2-108 and CAL. RULES OF PROFESSIONAL CONDUCT, Rule 209 which prohibit a lawyer from entering into such agreements, except if the lawyer is retiring from the firm. See generally *Roberts v. Pfefer*, 13 Cal. App. 3d 93, 91 Cal. Rptr. 308 (1st Dist. 1970).

⁶⁸ In *McCallum v. Asbury*, 238 Or. 257, 393 P.2d 774 (1964), the Supreme Court of Oregon enforced a non-competition clause which prohibited the expelled doctor from practicing within a 30-mile radius of Corvallis for 10 years. The majority had expelled the plaintiff by a majority vote, pursuant to such a clause in the partnership agreement. Justice Goodwin noted that the expelled partner accepted the terms of the agreement after carefully weighing the advantages, being most concerned with the restrictive covenant. However, the court observed that he had accepted the benefits of the possible application of the clause to newcomers to the partnership during his membership and could, thus, not complain when it was applied to him at his expulsion. 393 P.2d at 776.

⁶⁹ However, the expelled partner may be given his or her share of the monetary value of goodwill when the covenant forces the expelled partner to leave the immediate area.

might otherwise draw clientele away from the business.

Another device which may be beneficial in the event of expulsion is an arbitration clause.⁷⁰ Arbitration has numerous advantages over litigation including speed, low cost, malleability, privacy and convenience.⁷¹ However, there are also drawbacks to arbitration such as lack of traditional legal and evidentiary procedures,⁷² the possibility of a compromise where one party in fact has a valid claim, and the risk that the arbitrator will not be truly impartial.⁷³ The parties must balance these competing considerations.

The decision to arbitrate may ultimately rest upon the parties' attitude toward expulsion. As a general rule, where the parties' major concern is to expedite the expulsion once the decision to expel has been reached, an arbitration clause would be advisable. Conversely, if the parties are somewhat less receptive to the concept of expulsion and desire maximum legal protection in the event that it occurs, litigation would be preferable. The parties should be made aware, before including an arbitration clause, that absent procedural defects, the decision of an arbitrator is binding and cannot be appealed in court.⁷⁴

⁷⁰ "All deadlocks, or a defined class of differences of opinion among the partners can be resolved by arbitration." H. REUSCHLEIN & W. GREGORY, *supra* note 42, at 276. The parties must provide for arbitration either at the formation of the partnership in the drafted agreement or by written agreement subsequently adopted unanimously by the partners. The parties' choice of arbitration will preclude the possibility of litigating the issues unless all parties to the agreement consent to rescind the agreement to arbitrate. See CAL. CODE CIV. PROC. § 1281 (West 1972) which provides that: "A written agreement to submit to arbitration an existing controversy or a controversy thereafter arising is valid, enforceable and irrevocable, save upon such grounds as exist for the revocation of any contract." Also of significance is the provision in the U.P.A. concerning arbitration: "Unless authorized by the other partners or unless they have abandoned the business, one or more but less than all the partners have no authority to submit a partnership claim or liability to arbitration or reference." U.P.A. § 9(3)(e); CAL. CORP. CODE § 15009(3)(e) (West 1977).

⁷¹ Feldman, *Arbitration Law in California: Private Tribunals for Private Government*, 30 S. CAL. L. REV. 375, 384-86 (1957).

⁷² *Id.* at 454 & n.326.

⁷³ *Id.* at 475.

⁷⁴ "If a[n arbitration] petition or response under this chapter is duly served and filed, the court shall confirm the award as made unless in accordance with this chapter it corrects the award and confirms it as corrected, vacates the award or dismisses the proceeding." CAL. CODE CIV. PROC. § 1286 (West 1972) (emphasis added). See *Goldkette v. Daniel*, 70 Cal. App. 2d 96, 160 P.2d 145

Thus, partners can structure the basic components of an expulsion clause to meet their specific needs. They can also vary the impact of the expulsion clause by including certain complementary provisions in the partnership agreement. However, even when the attorney carefully drafts the provisions which the partners select, a disgruntled outgoing partner may still be able to contest some facet of expulsion.

III. ISSUES WHICH MAY BE CONTESTED

When drafting an expulsion clause, the parties should consider the possibility that the outgoing partner will want to challenge the expulsion in court.⁷⁵ The attorney should structure the content of dispute resolution so as to minimize the risk of an inequitable or unintended judicial interpretation.⁷⁶ The range of issues which can be contested,⁷⁷ and therefore the complexity, length and expense of the suit, will depend in part upon whether the expulsion clause allows for expulsion for or without cause.

Whether the partnership agreement provides for expulsion without cause or for cause, the expelled partner may contest such expulsion in two general areas: that the expulsion was procedurally defective or that it was not bona fide according to the agreement. Procedural defects would include inadequate notice

(2nd Dist. 1945), where a confirmed arbitration award held that a partnership between entertainers and their manager had been dissolved. The court found that the finality of the award barred the manager from bringing an action for an accounting for subsequent profits.

⁷⁵ Sheppard discusses three grounds upon which the courts may review a partner's expulsion under British law. Each ground is based on a theory of the nature of a member's rights in a partnership. First is the property theory, under which a partner's expulsion is reviewable if the expelled partner is deprived of some property right. Second is the contract right, based on the notion of rights granted in the agreement, reviewable if its terms are breached. Third is the tort theory, involving review of possible wrongful deprivation of the status as a member. Sheppard, *Some Aspects of the Law of Unincorporated Associations*, 3 U. BRIT. COLUM. L. REV. 135, 150 (1967).

⁷⁶ For example, a clause providing for expulsion for professional misconduct might specify that the standard of misconduct to be applied is that of the regulatory organization of the profession; i.e., the A.M.A. or A.B.A. In this manner, the parties can avoid ad hoc judgments as to the meaning of misconduct should the issue be challenged in court.

⁷⁷ These issues include the extent of damages owed to a partner, determination of the rights and liabilities of that partner and whether or not there was a right to dissolve pursuant to the agreement.

or unfair settlement of accounts in accordance with the terms of the partnership agreement.⁷⁸ In this situation, the court's role would be to interpret the expulsion clause and determine whether the parties complied with its terms in expelling the partner.

A second possible ground for contest would be an allegation that the expelling partners did not act in good faith.⁷⁹ Section 31(1)(d) of the U.P.A. requires that expulsion be "bona fide", but offers no clarification as to the meaning of "bona fide" in this context.⁸⁰ U.P.A. § 21 imposes a fiduciary duty upon the partners in their relations *inter se*, which continues through a dissolution of the partnership.⁸¹ "Bona fide" would thus appear

⁷⁸ Another example of a procedural dispute would be whether the expulsion was arbitrable under the agreement. In *Essenson v. Upper Queens Medical Group*, 307 N.Y. 68, 120 N.E.2d 209 (1954) the Court of Appeals held that the procedure for expulsion had been followed as provided in the partnership agreement.

⁷⁹ In *Gill v. Mallory*, 274 A.D. 84, 80 N.Y.S.2d 155 (1948), two expelled partners challenged the action of the majority, alleging bad faith. The majority had expelled the plaintiffs pursuant to an expulsion clause in the partnership agreement which required a majority vote and no showing of cause. The expelled partners were treated as if they had retired. The court found no bad faith on the part of the expelling partners since they acted in conformance with the agreement. Judge Van Voorhis ruled that, "it was the purpose of the clause to avoid, if possible, the legal proceedings involved in dissolution and winding up of the partnership if the members of the firm should find themselves in discord and unable to continue functioning harmoniously as a partnership." *Id.* at 85, 80 N.Y.S.2d at 156-57.

⁸⁰ See U.P.A. § 31(1)(d); CAL. CORP. CODE § 15031(1)(d) (West 1977), set forth in note 13 *supra*. The Alabama legislature, when enacting the U.P.A., changed the words "bona fide" to "in good faith," suggesting its desire to clarify the meaning of the term. ALA. CODE tit. 43, § 5(31)(1)(d) (Supp. 1979).

⁸¹ See U.P.A. § 21(1); CAL. CORP. CODE § 15021(1) (West 1977), set forth in note 7 *supra*. See also Davies, *The Good Faith Principle and the Expulsion Clause in Partnership Law*, 33 CONV. 32 (1969). Davies asserts that under English law, the foundation of the U.P.A., there is an implied duty to act in good faith in every aspect of the partnership relationship. In reference to expulsion, he equates the term "bona fide" with a duty not to gain economic advantage by expelling a partner. The concept of economic advantage that Davies discusses is analogous to that contained in U.P.A. § 21. Generally, cases on dissolution hold that partners have a fiduciary duty which extends through the dissolution and liquidation of the partnership, requiring that they deal fairly with co-partners and not conceal matters relating to the business and property of the partnership. See *Vai v. Bank of America National Trust and Savings Assoc.*, 56 Cal. 2d 329, 364 P.2d 247, 15 Cal. Rptr. 71 (1961); *Laux v. Freed*, 53 Cal. 2d 512, 348 P.2d 873, 2 Cal. Rptr. 265 (1960); *Howell v. Bowden*, 368

to require that the partners at least meet this all-encompassing fiduciary duty. This interpretation imposes an obligation of good faith in the expulsion of a partner. Therefore, if a court finds that a proposed expulsion is the consequence of a potential monetary or property gain, it could then determine that the expulsion is not "bona fide" and hence invalid.

Clauses providing for expulsion for cause are more likely to generate litigation or arbitration than those which allow expulsion without cause. In the former, the parties and ultimately a court must make more factual determinations.⁸² If the causes listed are general, and they usually will be, they will be subject to conflicting interpretations.⁸³ Differing interpretations may well lead to litigation. In this situation, the outgoing partner can successfully demand that a judge, jury, or arbitrator determine whether cause for expulsion actually exists.⁸⁴

Expulsion without cause provides the expelled partner with fewer grounds to contest the expulsion than expulsion for cause. Where expulsion is without cause, the courts may apply a good faith requirement less strictly than if the expulsion were for cause.⁸⁵ If the court required a showing of good faith by the ex-

S.W.2d 842 (Tex. App. 1963); *Van Hooser v. Keenan*, 271 S.W.2d 270 (Ky. App. 1954). Since expulsion is a form of dissolution under U.P.A. § 31(1)(d), the same principles of fair dealing would apply and fiduciary duties should extend to expulsion.

⁸² The expelling partners must be able to show that the facts actually exist to justify expulsion for cause. *J. CRANE*, *supra* note 35, at 400.

⁸³ The use of general terms, such as "immorality" or "inactivity" to describe actionable conduct may be preferable to more specific terms. Specific terms may not prohibit all activity which the partners deem offensive. Thus, a certain degree of generality is necessary to make the clause effective.

⁸⁴ In *Essenson v. Upper Queens Medical Group*, 307 N.Y. 68, 120 N.E.2d 209 (1954), the outgoing partner had the original burden to show that he was expelled in bad faith. Once he established a *prima facie* showing that the expulsion was invalid, the burden shifted to the remaining partners to justify either the procedure or the grounds for expulsion.

⁸⁵ See *Gelder Medical Group v. Webber*, 41 N.Y.2d 680, 363 N.E.2d 573, 394 N.Y.S.2d 867 (1977). The Court of Appeals stated that there is essentially no good faith requirement but if there were, the remaining partners were presumed to have expelled the physician in good faith pursuant to a clause providing for expulsion without cause. The court recognized that the purpose of a without cause clause is to avoid litigation, thus justifying the presumption of good faith. But if the expelled partner were to allege and prove bad faith going to the making of the clause itself, then the agreement itself would be voidable. *Id.* at 684, 363 N.E.2d at 577, 394 N.Y.S.2d at 871.

elling partners, this burden would tend to nullify the expeditious nature of the expulsion without cause clause.⁸⁶ Without strict application of a good faith requirement, the expelled partner could only contest an expulsion without cause on procedural grounds, considerably lessening the possibility of litigation or arbitration.

CONCLUSION

Partners should always consider the inclusion of an expulsion clause during the formation of their business.⁸⁷ Should expulsion of a partner become necessary, an expulsion will allow for efficient resolution of the problems with minimal loss to the partnership. To serve as an effective safeguard against potential loss, however, the expulsion clause must be carefully drafted. With proper planning, the various components of an expulsion clause can not only provide the basis for ousting an incompatible partner, but can also protect the rights and interests of all involved parties.

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⁸⁶ In *Holman v. Coie*, 11 Wash. App. 195, 522 P.2d 515 (1974), the court upheld the expulsion of a lawyer accomplished by a majority vote pursuant to a clause which required no finding of cause. The expelled partner challenged the validity of the expulsion clause by alleging that it violated the fiduciary duty that partners owed one another. The court found the clause's language unambiguous and refused to read into it any duty to preserve the membership. The court noted that the foundation of a lawyer's relationship with his or her firm is personal confidence and trust. Once this harmonious accord is destroyed, an expeditious severance is desirable. *Id.* at 196, 522 P.2d at 524.

⁸⁷ See C. KARPLUS, *supra* note 34.