

Expelling Partners: The Legal And Ethical Issues

BY ROY SIMON

Suppose your law firm opened an out-of-town office a few years ago and now finds that the office is unprofitable. You run the numbers and realize that the firm's most senior partners could make a lot more money if the out-of-town office was shut down. Unfortunately, the out-of-town office is headed by a partner, so the firm can't just fire him. Then someone comes up with a bright idea: close the out-of-town office and offer the partner a transfer to another of the firm's out-of-town offices, say the Washington, D.C. branch. Good idea?

Don't try it, or your firm may repeat the outcome of *Beasley v. Cadwalader, Wickersham & Taft*, 1996 WL 438777 (Fla. Cir. Ct. 1996). Beasley was a Florida real estate lawyer who had practiced in Florida for nearly twenty years. When Cadwalader wanted to expand into Florida, it hired Beasley as a partner and opened a Palm Beach office. Shortly afterwards, senior partners at Cadwalader began complaining about declining compensation and suggested that closing the Palm Beach office would help stop the decline. But what could the firm do about Beasley? Cadwalader's partnership agreement did not contain an expulsion clause, so expelling Beasley would breach the partnership agreement. If Beasley voluntarily withdrew from the firm, however, the firm would not be breaching the partnership agreement. The firm therefore decided to close the Palm Beach office and offer Beasley a transfer to the firm's Washington, D.C. or New York offices. As the firm expected, Beasley declined this offer – and then he sued the firm in Florida for wrongful expulsion and breach of fiduciary duty.

Court Finds Breach Of Fiduciary Duty

The Florida court, applying New York partnership law, agreed with Beasley that the transfer offer was unreasonable and therefore amounted to an expulsion. The court also took note of deposition testimony from Cadwalader's Co-Chair that "there always will be a fear that highly productive partners ... can leave, go to another place and get more money. And life is not made up of love, it is made up of greed and money." Viewing the unreasonable transfer offer in light of this motive, the court held that Cadwalader's conduct fell squarely within Justice Cardozo's famous ruling in *Meinhard v. Salmon*, 249 N.Y. 458 (1928), that it was "a gross breach of fiduciary duty for some partners to throw others overboard for the expediency of increased profits." The court therefore awarded Beasley a return of his capital (with interest), profits, attorney's fees, costs, and punitive damages. The appellate court reversed the award of profits, attorney's fees, and costs, but affirmed the award of punitive damages and the return of Beasley's capital with interest. Both sides petitioned for a rehearing, which was granted, but the opinion on rehearing was essentially the same, again affirming the punitive damages award. Shortly afterwards, Beasley and Cadwalader settled.

ABCNY Report Reviews “Unpartnering”

The *Beasley* case is not news — but a new report by the New York City Bar’s Committee on Professional Responsibility entitled *Unpartnering: An Overview of the Legal and Ethical Issues* is news. Published in the January/ February 2000 issue of THE RECORD, the ten-page report reviews general principles of “unpartnering” in light of the Revised Uniform Partnership Law, the principles of good faith and fiduciary duty, and recent case law. The report points out that New York law does not give partners any common law or statutory right to expel another partner from a partnership. However, a partnership agreement may contain an expulsion clause, and such a clause will be enforced provided the partnership strictly adheres to its terms and applies it in good faith. The report looks to a leading treatise, HILLMAN ON LAWYER MOBILITY, listing seven elements that an expulsion clause should include:

- who in the partnership has power to expel other partners
- the percentage approval required to expel a partner
- whether an expulsion must be for cause
- the availability of procedural protections for the partner facing expulsion
- the method for settling the account of the expelled partner
- the effective date of the expulsion
- how the expelled partner will be protected against future claims against the partnership

Report Offers Key Advice

The report then gives the following key advice:

A solid expulsion clause is critical to the partnership agreement because the “firing” of a partner without such a clause may be considered a dissolution by express will of the partners. In this case, a partner fired without a valid expulsion clause may successfully demand a liquidation and winding up of the partnership. However, inclusion of a no- cause expulsion clause in a partnership agreement does not guarantee conflict-free expulsions. In fact, many partners expelled pursuant to a no-cause expulsion provision have litigated the matter, complaining of breach of fiduciary duty and breach of contract, or arguing that the expulsion clause was unenforceable, or was exercised in bad faith.

The report then discusses the principles of good faith and fiduciary duty, pointing out that “partners owe each other a duty of good faith no less in the context of expulsion, even where the partnership agreement permits expulsion without cause” (emphasis added), and that the success of an expelled partner’s claim for wrongful expulsion or breach of fiduciary duty (the claims that *Beasley* asserted against *Cadwalader*) “usually will depend on whether the decision to expel was tainted by bad faith or breach of fiduciary duty.”

Report Reviews Cases

The report then reviews *Beasley* and four other cases in which partners sued to challenge an expulsion, concluding with the following summary of the case law:

The underlying theme present in all expulsion cases has been the need for an explicit clause in the partnership agreement regarding expulsions as well as the duty of partners to act in good faith and without breach of fiduciary duty. Satisfying these conditions, a partnership may freely

remove any of its partners unless the predominant motivation for doing so is to increase compensation for other partners, as demonstrated clearly in the Beasley case. This rule distinguishes law firm partnerships from other business partnerships which commonly downsize to allow for increased revenue.

Finally, the report calls for reform, recommending that “law partners should be able to include ... explicit language in partnership agreements allowing for expulsion due to financial considerations such as lack of productivity, declining revenues, or desire to increase partner compensation.” Until that reform comes about, however, any partnership thinking about expelling a partner should carefully read the report on “unpartnering” and the cases and other authorities cited in the report. Ignoring those cases and authorities could be very costly. Just ask Cadwalader.

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