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ENTITY EXIT: RIGHTS, REMEDIES, AND BOUNDED RATIONALITY

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I. INTRODUCTION

Exit from a business entity can occur in a number of ways. Exit can occur as a result of individual action. For example, a shareholder of a corporation can sell her shares in the corporation.[1] Exit can also occur by collective action.[2] Sticking with the corporate context, the shareholders of a corporation can vote to approve a recommendation by the board of directors to dissolve the corporation.[3] These two examples also demonstrate that the consequences of exit can be different. In the first example, the shareholder ends her relationship with the entity, but the entity continues.[4] In the second example, the collective action leads to the dissolution of the entity through liquidation.[5] However, the consequences of the exit are not necessarily tied to the individual versus collective nature of the action causing the exit. For example, an individual exit can lead to the dissolution of the entity. A single partner in a partnership at will can cause the dissolution of the partnership by merely expressing her will to cease to be associated with a partnership.[6] Conversely, collective exit does not necessarily lead to the termination of the entity. The deaths of multiple partners in a partnership at will or a partnership for a term will cause their interests in the partnership to cease, but will not necessarily lead to the dissolution of the partnership.[7] This article explores the intersection of the nature of the action leading to exit and the consequences of exit. It will argue that, because of bounded rationality, as individual exit becomes more difficult, collective exit should become easier. This conclusion is independent of whether the consequence of individual exit or collective is the dissolution of the entity.

Individual action leading to an exit from a business entity can occur in a number of ways and lead to a number of consequences. As noted above, in some business entities an owner's interest is freely transferable. For such entities, exit can occur when an owner sells her interest to someone else. Of course, this depends

1. *See* MODEL BUS. CORP. ACT § 6.27(a) (AM. BAR ASS'N 2010). No provision in the MBCA explicitly authorizes the shareholder to transfer shares. However, the absence of such provision coupled with an express provision governing share transfer restrictions implies that either the shareholders may freely transfer shares to prevent such transfers in the absence of transfer restrictions set out in the articles of incorporation, bylaws, an agreement among shareholders, or an agreement between shareholders and the corporation.

2. *See id.* § 14.02(a).

3. *See id.* § 14.02(b)(2).

4. *See id.* § 6.27(a).

5. *See id.* § 14.03(c).

6. *See* UNIF. P'SHIP ACT § 31(1)(b) (1914) (superseded 1992).

7. *See* UNIF. P'SHIP ACT § 801 (1997) (amended 2013) (death not listed as cause for dissolution and liquidation).

on finding a willing buyer. In other entities, an owner can exit by unilateral action. This could include merely expressing the desire to leave the entity. Death of the owner can also lead to exit in some entities. Exit of an individual owner is sometimes caused by the individual or collective action of others. An owner can sometimes be expelled by a court order at the behest of another owner or owners. Exit by court order is not limited to expulsions. Sometimes an individual owner will petition a court for a dissolution or a buyout. The consequences of an individual exit can vary. An individual exit can lead to a dissolution or a buyout.[8] The individual may be liable for damages caused to the entity by the exit.[9] If a buyout is ordered, the payment may be delayed until a later date.[10] In the event of such a delay, the owner is sometimes compensated by interest and sometimes by the continuing participation in profits.[11] Sometimes the exit rights of an owner will depend on whether another owner has already exited. In summary, the analysis must focus both on the action causing the exit and on the consequences of the exit. Both of these vary among types of entities.

Similarly, collective action can lead to exit from a business entity with varying consequences. Most of the individual action described above can take place by multiple actors. Multiple actors can sell their interests, express their desire to leave, die, or be expelled. These actions can occur simultaneously or serially. The consequences of all of the actions can vary. Multiple actors can petition for a court-ordered dissolution or a buyout. Collective action can lead to exit in other ways. Mergers can be structured to cause the exit of some owners. This can occur over the objection of those owners. Finally, collective action can lead to the voluntary dissolution of the entity. This can require majority action, super majority action, or unanimity depending on the type of entity.

All of the default rules governing exit from business entities involve complex combinations of rights and remedies.[12] Sometimes

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8. *See* UNIF. P'SHIP ACT § 38(1) (1914) (superseded 1992); *see also* Dreifuerst v. Dreifuerst, 280 N.W.2d 335, 337 (Wis. Ct. App. 1979). *But cf.* Disotell v. Stiltner, 100 P.3d 890, 894 (Alaska 2004) (explaining dissolution is not always appropriate).

9. UNIF. P'SHIP ACT § 38(2)(a)(II) (1914) (superseded 1992).

10. *See id.* § 38(2)(b).

11. *See id.* § 42.

12. The rules discussed in this article are primarily default rules. *See* Robert Gertner & Ian Ayres, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 93–100 (1989) (discussing majoritarian default rules and offering an analysis of penalty default rules as an alternative). They can be changed by private ordering among the owners. The form of the private ordering depends on the type of business entity. In a partnership, the private ordering takes the form of the partnership agreement. In a corporation, private ordering can occur in the articles of incorporation or the corporation's bylaws. In a limited liability company, the operating agreement among the owners governs

rights to exit or prevent the exit of others exist, but are highly conditional. Sometimes such rights exist, but are enforced by weak remedies. Sometimes rights to exit depend upon a majority of owners or the owners of a majority interest desiring an exit. Because of bounded rationality, at the inception of a business entity, it is often impossible to predict either which owners will later desire an exit or which owners will end up in a majority when a dispute about exit arises.

The next three sections will analyze the individual and collective actions leading to exit in the three main types of business entities, partnerships, corporations, and limited liability companies (LLCs). Section V will analyze the relationship of rights and remedies. Section VI will analyze the relationship of individual exit to collective exit. Section VII will analyze the effects of bounded rationality on the choice of exit norms.

II. EXIT UNDER PARTNERSHIP LAW

Partnership law has been heavily influenced by two versions of the Uniform Partnership Act. The 1997 version of the Uniform Act is in force in some form in most states.[13] However the 1997 version has not been universally accepted. The 1914 version of the Uniform Act is still in force in a minority of states, including some commercially important states such as New York. The two versions of the Uniform Act vary in important ways as applied to exit. While the law applied to exit from partnerships varies, so do the facts affecting exit rights. The most important fact affecting exit rights is whether the partnership is at will or for a term or an undertaking. As one would expect, exit is substantially easier in a partnership at will than it is in a partnership for a term or an undertaking. However, exit from a partnership for a term is easier than many would expect. The following subsections will explore these differences.

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the relationship among the owners. Default rules are important because they relieve the owners of the often difficult and costly process of predicting issues that may arise in the future and tailoring a set of resolutions to those issues. Default rules are often crafted to yield an outcome that most people would desire if they took the time and trouble to engage in private ordering. These default rules are referred to as majoritarian default rules. Default rules are often crafted to yield an outcome that most people would desire if they took the time and trouble to engage in private ordering.

13. *See* UNIF. LAW COMM'N, Legislative Fact Sheet – Partnership Act (1997) (Last Amended 2013), http://www.uniformlawcommission.com/LegislativeFactSheet.aspx?title=Partnership%20Act%20(1997)%20(Last%20Amended%202013) (last visited September 10, 2016) [http://perma.cc/7KHU-CNAF].

A. *Exit in Partnerships at Will*

When partners form a partnership, they can expressly or impliedly agree to remain partners for a specific period of time or until they accomplish a particular objective.[14] If the partners do not enter into such an agreement for a term or undertaking, their partnership is at will.[15] Under the Uniform Partnership Act (1914), in a partnership at will, a partner can exit the partnership at any time by expressing the will to withdraw.[16] This exit leads to the dissolution and liquidation of the partnership, unless the partners otherwise agree.[17] The Uniform Partnership Act (1997) provides for the same result.[18] Therefore, a partnership at will is a fragile entity.[19] Any partner can leave the partnership at any time, and the default consequence of this exit is the dissolution and liquidation of the partnership.[20] This fragility can lead to opportunistic behavior by partners who would benefit from the dissolution and ensuing liquidation of the partnership. Partners who can buy its assets at the liquidation sale or who have close relationships with the firm's customers or suppliers could seek to capitalize on these strategic advantages by forcing a dissolution and liquidation.

The Uniform Partnership Act (1914) and the Uniform Partnership Act (1997) differ in their treatment of exit by death. Under the Uniform Partnership Act (1914), death leads to a dissolution and liquidation of the partnership as a matter of default.[21] The Uniform Partnership Act (1997), provides that death leads to an exit from the partnership.[22] However, death is not listed as one of the causes of dissolution and liquidation.[23] Under the Uniform Partnership Act (1997), if an exit occurs but does not lead to a dissolution and liquidation, a buyout of the

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14. Page v. Page, 359 P.2d 41, 43 (Cal. 1961).

15. *See, e.g.*, Clark v. Fiedler, 113 P.2d 275, 281 (Cal. Ct. App. 1941).

16. UNIF. P'SHIP ACT § 31(1)(b) (1914) (superseded 1992); Girard Bank v. Haley, 332 A.2d 443, 446 (Pa. 1975).

17. *See* UNIF. P'SHIP ACT § 38(1) (1914) (superseded 1992); *see also* Dreifuerst v. Dreifuerst, 280 N.W.2d 335, 337 (Wis. Ct. App. 1979). *But cf.* Disotell v. Stiltner, 100 P.3d 890, 894 (Alaska 2004) (explaining dissolution is not always appropriate).

18. UNIF. P'SHIP. ACT §§ 601(1), 801(1) (1997) (amended 2013).

19. *See, e.g.*, Robert W. Hillman, *RUPA and Former Partners: Cutting the Gordian Knot With Continuing Partnership Entities*, 58 LAW & CONTEMP. PROBS, 7, 10 (1995).

20. *See* UNIF. P'SHIP ACT § 38(1) (1914) (superseded 1992); *see also* Dreifuerst v. Dreifuerst, 280 N.W.2d 335, 337 (Wis. Ct. App. 1979). *But cf.* Disotell v. Stiltner, 100 P.3d 890, 894 (Alaska 2004) (explaining dissolution is not always appropriate).

21. *See* UNIF. P'SHIP ACT §§ 31(4), 38(1) (1914) (superseded 1992); *see also* Girard Bank, 332 A.2d at 446.

22. *See* UNIF. P'SHIP ACT § 601(7)(A) (1997) (amended 2013).

23. *See* UNIF. P'SHIP ACT § 801 (1997) (amended 2013) (death not listed as cause for dissolution and liquidation).

partner's interest occurs.[24] Therefore, the Uniform Partnership Act (1997) provides liquidity for the estate of a deceased partner, however, the estate cannot force a liquidation.[25]

The buyout provided by the Uniform Partnership Act (1997) raises the thorny issue of valuation. This issue will reoccur whenever an owner has a buyout right rather than a right to force a liquidation.[26] Indeed, one of the advantages of a dissolution and liquidation is that it avoids the issue of valuation. In a liquidation, the assets of the firm are sold. The proceeds of the sale are first used to pay the firm's creditors and any money left is divided among the firm's owners.[27] However, in the context of a buyout, if the firm and the party entitled to a buyout cannot reach an agreement about the value of the interest subject to the buyout, a court will be called upon to determine the buyout price.[28] For small business entities there are no well-developed, active markets for the business interest in question. In markets for commodities or some types of real property there are frequent sales of similar products. Similarly, in markets for shares of large publicly traded companies, purchases and sales occur many times a day. However, small businesses are infinitely variable, as are the interests of individual co-owners of various businesses. Therefore, courts have no easily available information about recent sales of similar business interests. This creates great uncertainty about what price the court will impose on the parties of the buyout. This uncertainty is a disadvantage for the buyer and the seller.

Expressions of the desire to leave a business entity and death are not the only events that can lead to exit from a business entity.[29] When owners become unhappy with each other, they may seek to expel another owner from the entity while continuing to operate the entity themselves.[30] Alternatively, owners may

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24. *See id.* § 701(a).

25. The relationship between exits that cause a dissolution and those that do not will be discussed in detail in connection with exits from partnerships for a term in the next subsection. *See infra* text accompanying notes 48–53.

26. Buyouts occur under the Uniform Partnership Act (1997) when a partner dies, when a partner wrongfully expresses the will to leave a partnership for a term, and when a partner is expelled by a court order. *See* UNIF. P'SHIP ACT § 601 (amended 2013). In the corporate context, a buyout will sometimes occur when a shareholder has petitioned for a court-ordered dissolution, but the court orders a buyout instead. *See* In re Dissolution of Clever Innovations, Inc., 941 N.Y.S.2d 777, 779–780 (N.Y. App. Div. 2012).

27. The division of assets among the firm's owners will vary depending on the original contributions to the entity by the owners and upon whether profits are allocated equally or proportionately to the contributions of the owners. *See* UNIF. P'SHIP ACT § 806 (amended 2013). These rules vary among different types of entities.

28. *See* Disotell v. Stiltner, 100 P.3d 890, 894 (Alaska 2004).

29. *See* UNIF. P'SHIP ACT § 31 (1914) (superseded 1992) (listing the different ways a dissolution may occur).

30. *See* UNIF. P'SHIP ACT § 601(5) (1997) (amended 2013).

collectively cause a dissolution, potentially over the objection of other owners who would like to keep the entity intact.[31] These situations have little practical impact in partnerships at will. If some partners want to expel a fellow owner and continue the partnership without the expelled partner, the object of the attempted expulsion can express the will to dissolve and force a liquidation. Similarly, a partnership vote to cause a dissolution over the objection of partners who would like to keep the partnership intact does not arise in a partnership at will. In a partnership at will, even a single partner can cause a dissolution and liquidation over the objection of all of the other partners.[32] These scenarios raise important and complex issues in other business entities, including partnerships for a term or undertaking.

B. *Exit in Partnerships for a Term or Undertaking*

Rather than entering into an at will relationship, partners can agree to continue their relationship until the expiration of a term or until they accomplish a particular undertaking. Such agreements can be implied by the conduct of the partners.[33] However, just because partners agree to a term or an undertaking does not mean that they must remain partners until the expiration of the term or the accomplishment of the undertaking. Instead, partners are allowed to exit prematurely and face potentially unpleasant remedies. Further, a premature exit will affect the rights of the remaining partners. The Uniform Partnership Act (1914) and the Uniform Partnership Act (1997) treat exit from partnerships for a term differently.

The Uniform Partnership Act (1914) allows a partner in a partnership for a term to exit the partnership by expressing the will to cease to be associated with the carrying on of the business.[34] However, the exiting partner is liable for any damages caused to the partnership.[35] The remaining partners have the right to continue the partnership business for the remainder of the term, possess its property, and use the name, so long as all the remaining partners consent.[36] The continuing partners are required to pay to the exiting partner the value of her interest, less

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31. *See id.* § 32 (showing that a court shall decree a dissolution over objection of other owners if it has satisfied Section 32).

32. *See, e.g.*, Hillman, *supra* note 19.

33. *See* Zeibak v. Nasser, 82 P.2d 375, 381 (Cal. 1938).

34. *See* UNIF. P'SHIP ACT § 31(2) (1914) (superseded 1992).

35. *See id.* § 38(2)(a)(ii).

36. *See id.* § 38 (2)(b).

damages, not counting goodwill.[37] The continuing partners may defer paying this amount until the end of the term[38] if they post a court approved bond to secure the payment.[39] The exiting partner is entitled to indemnity against creditors[40] and at her election can receive an interest or a share of profits to compensate her for the delay in payment.[41]

Thus, a partner in a partnership for a term or undertaking is not required to remain a partner. She may express the will to leave the partnership and cease being a partner. In some situations her exit may not subject her to many adverse consequences. Her exit may not cause much damage to the partnership. Further, all of the remaining partners may not wish to continue the business and the partnership will then dissolve. Even if all of the remaining partners do desire to continue the business, they may decide to pay the exiting partner immediately. Even if they do not, the exiting partner has her interest secured by a court-approved bond and will receive, at her election, an interest or a share in the profits of the continuing business. At the most basic level, even if a partner has contracted to remain a partner for a specified time, she may still exit the partnership at her election. Her promise to remain in the partnership is not specifically enforceable.

Under the Uniform Partnership Act (1997), a partner in a partnership for a term or undertaking may also exit the partnership by expressing the will to leave.[42] However, the consequences of that exit are different, both for the exiting partner and the other partners.[43] The Uniform Partnership Act (1997) introduced an additional concept addressing exit in addition to dissolution. A partner's exit from a partnership is called a dissociation.[44] The exit will sometimes cause a dissolution.[45] However, a dissociation may occur without causing a dissolution.[46] Therefore, the list of events causing a dissociation is longer than

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37. *See id.* § 38 (2)(c)(ii).

38. Although section 38 does not expressly specify the time of payment, it does provide that the continuation right is for the remainder of the specified term. *See id.* § 38 (2)(b).

39. *See id.*

40. *See id.* § 38(2)(b) (1914) (superseded 1992).

41. *See id.* § 42; *see also* Matteson v. Matteson, 2008 WI App 71, ¶ 25, 309 Wis. 2d 311, 331, 749 N.W.2d 557, 567–68 (explaining that an exiting partner has two primary options upon a partnership dissolution when payment is delayed: interest or profits).

42. *See* UNIF. P'SHIP ACT § 601(1) (1997) (amended 2013).

43. *See* Shoemaker v. Shoemaker, 745 N.W.2d 299, 310 (Neb. 2008).

44. *See* UNIF. P'SHIP ACT § 601 (1997) (amended 2013); McCormick v. Brevig, 2004 MT 248, ¶ 34, 322 Mont. 112, 121, 96 P.3d 697, 703.

45. *See* UNIF. P'SHIP ACT § 801 (1997) (amended 2013).

46. *See id.* § 701(a).

the list causing dissolution.[47] If a partner in a partnership for a term expresses the will to withdraw from the partnership, that expression constitutes a dissociation[48] but does not cause a dissolution.[49] The dissociating partner owes the partnership damages caused by the early exit.[50] The dissociating partner is entitled to a buyout at the greater of liquidation or going concern value.[51] Unlike the Uniform Partnership Act (1914), there is no exclusion of the value of goodwill.[52] The dissociating partner must be indemnified against partnership creditors[53] and receives interest until her buyout is paid.[54] Unlike the Uniform Partnership Act (1914), the exiting partner does not have the option of receiving a share of the profits instead of interest.[55] The buyout price is due at the end of the term, unless the dissociating partner can show that the partnership would suffer no undue hardship if it is required to pay earlier.[56] The delayed payment must be adequately secured.[57] Unlike the Uniform Partnership Act (1914), there is no requirement that the security take the form of a court approved bond.

One of the most significant differences in the treatment of exit by expression under the Uniform Partnership Act (1914) and the Uniform Partnership Act (1997) relates to the rights of partners who do not want to continue with the partnership following someone else's exit. Under the Uniform Partnership Act (1914), the continuation of the partnership business without liquidation requires the consent of all of the remaining partners.[58] Therefore, if one of the remaining partners wants to force a liquidation following the exit of a wrongful partner, she may do so by withholding her consent to the continuation. However, under the Uniform Partnership Act (1997) following a wrongful exit by expression the partnership continues unless half of the remaining partners state their desire to leave the partnership within ninety days of the original wrongful exit.[59] If fewer than half of the

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47. *Compare* UNIF. P'SHIP ACT § 601 (1997) (amended 2013), *with* § 801.
48. *See* UNIF. P'SHIP ACT § 601(1) (1997) (amended 2013).
49. *See id.* § 801(1).
50. *See id.* § 602(c).
51. *See id.* § 702(b); *McCormick*, 96 P.3d at 703.
52. *Compare* UNIF. P'SHIP ACT § 38(2)(c)(II) (1914) (superseded 1992), *with* UNIF. P'SHIP ACT § 702(b) (1997) (amended 2013).
53. UNIF. P'SHIP ACT § 701(d) (1997) (amended 2013).
54. *See id.* § 701(b).
55. *Compare* UNIF. P'SHIP ACT § 42 (1914) (superseded 1992), *with* UNIF. P'SHIP ACT § 701(b) (1997) (amended 2013).
56. UNIF. P'SHIP ACT § 701(h) (1997) (amended 2013).
57. *Id.*
58. *See* UNIF. P'SHIP ACT § 38(2)(b) (1914) (superseded 1992).
59. *See* UNIF. P'SHIP ACT § 801(2)(A) (1997) (amended 2013).

remaining partners desire to leave, they may rightfully dissociate so long as they do it within the same ninety day period.[60] As rightfully dissociating partners they do not owe damages[61] or face a delay in payment.[62] However, they cannot force a liquidation. Therefore, a partnership for a term formed under the Uniform Partnership Act (1997) is less fragile than a partnership for a term formed under the Uniform Partnership Act (1914) following a wrongful exit by expression. This is because it takes half of the remaining partners to force a liquidation rather than just one.

The treatment of death as an exit event in partnerships for a term under both partnership statutes parallels its treatment in partnerships at will. Under the Uniform Partnership Act (1914), death leads to a dissolution,[63] while under the Uniform Partnership Act (1997) death leads to a dissociation but not a dissolution.[64] The Uniform Partnership Act (1997) treats the rights of the surviving partners following a dissociation by death in the same way it does those rights following a wrongful dissociation by expression.[65] If within ninety days of the death at least half of the remaining partners opt to leave the partnership, it is dissolved.[66] If fewer than half of the remaining partners opt to leave they may rightfully dissociate within ninety days[67] without facing a delay in payment[68] or liability for damages.[69] Therefore, a partnership formed under the Uniform Partnership Act (1997) is less fragile than one formed under the Uniform Partnership Act (1914) in the event of the death of a partner in a partnership for a term.

Discord among partners is a more serious matter in a partnership for a term than in a partnership at will. In a partnership at will, if discord develops among partners, anyone may express the will to exit and force a dissolution.[70] However, in a partnership for a term, anyone who responds to discord by expressing the will to leave will be a wrongfully withdrawing partner.[71] Such an exiting partner would face the damages

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60. *See id.* § 602(b)(2)(A) (1997) (amended 2013).
61. *See id.* § 602(c).
62. *See id.* § 701(h).
63. UNIF. P'SHIP ACT §§ 31(4), 38(1) (1914) (superseded 1992).
64. *See* UNIF. P'SHIP ACT § 601(7)(A) (1997) (amended 2013).
65. *See id.* §§ 602, 701, 801.
66. *See id.* § 801(2)(A).
67. *See id.* § 602(b)(2)(A).
68. *But cf. id.* § 701(h) (suggesting that only partners who wrongfully dissociate a partnership face a delay in payment).
69. *But cf. id.* § 602(c) (suggesting that only partners who wrongfully dissociate as a partner are liable to the partnership for damages caused by the dissociation).
70. *See supra* text accompanying notes 16–18.
71. *See* UNIF. P'SHIP ACT § 602(b)(2)(A) (1997) (amended 2013).

available under both partnership statutes.[72] Partners unhappy with the conduct of other members of the partnership have options other than expressing under both partnership statutes.

Under the Uniform Partnership Act (1914), partners may be able to get a court-ordered dissolution and continue the partnership business without the partner who is behaving badly.[73] Events causing a dissolution include a decree of court.[74] Grounds for a court-ordered dissolution include conduct that is prejudicial to the carrying on of the business,[75] willful or persistent breaches of the partnership agreement,[76] and circumstances that make dissolution equitable.[77] If the complaining partners can establish such grounds the court shall decree a dissolution. The question then is whether the dissolution leads to a liquidation or whether the other partners can continue without the badly behaving partner.

The Uniform Partnership Act (1914) allows the remaining partners to continue the business if the dissolution is caused in contravention of the agreement and all of the remaining partners choose to continue.[78] As discussed above, in a partnership for a term, if a partner causes a dissolution of a partnership for a term by expressing the will to leave the partnership, the remaining partners have the right to continue.[79] If a partnership for a term is dissolved by court-order because a partner has willfully breached the partnership agreement, it can be argued that the dissolution was "caused in contravention of the partnership agreement."[80] The breaching partner would then be the one who "caused the dissolution wrongfully."[81] In effect, the petitioning partners would have expelled the breaching partner with the help of the court. One textual problem with this argument is that of the six causes of dissolution listed in section 31 of the Uniform Partnership Act (1914), only one is labeled as being in contravention of the agreement. That cause of dissolution is the expressed will of a partner in a partnership for a term.[82]

72. *See* UNIF. P'SHIP ACT § 38(2)(a)(II) (1914) (superseded 1992); UNIF. P'SHIP ACT § 602(c) (1997) (amended 2013).

73. *See* UNIF. P'SHIP ACT § 38(2)(b) (1914) (superseded 1992).

74. *Id.* § 31(6).

75. *Id.* § 32(1)(c).

76. *Id.* § 32(1)(d).

77. *Id.* § 32(1)(f).

78. *See id.* § 38(2)(b).

79. *See supra* text accompanying notes 36–41.

80. *See* UNIF. P'SHIP ACT § 38(2) (1914) (superseded 1992).

81. *Id.* § 38(2)(c).

82. *See id.* § 31(2).

Dissolution by decree of the court is not so labeled.[83] If the statute is read as limiting dissolutions in contravention of the agreement to those caused by expression, partners who are the victims of egregiously bad conduct by another partner would be forced to either put up with the conduct or face a liquidation of the partnership. The breaching partner could, of course, buy the assets of the partnership in the liquidation sale. A better interpretation of the statute would conclude that the breaching partner has caused the dissolution wrongfully and allow the rightful partners to continue with the partnership business for the agreed upon term.

The Uniform Partnership Act (1997) allows the rightful partners to force the wrongful partner out and continue the partnership business as of right. Among the events of dissociation listed in section 601 is "the partner's expulsion by judicial determination" on application of the partnership or a partner.[84] Grounds for such a judicial expulsion include wrongful conduct harming the partnership, breach of the partnership agreement, and conduct that makes it impractical to continue in business with the expelled partner.[85] If the partnership is for a term, such an expulsion is wrongful.[86] Therefore, the rightful partners would have the same rights to continue, dissociate, or dissolve that they would have if the wrongful partner had expressed the desire to leave in contravention of the term.[87] Rather than seeking to expel a partner who has behaved badly, an aggrieved partner can seek a court-ordered dissolution and liquidation of the partnership if a partner has behaved in a way that it is not practical to continue in business with that partner.[88]

One last form of dissolution of a partnership for a term is also important. Under both partnership statutes, a partnership for a term will dissolve if all of the partners want it to.[89] This is, of course, the case in any contractual commitment. If all of the parties to a contractual relationship want to end the relationship, they may. If partners agree to be in the buggy whip business for the next twenty years, they can unanimously agree to end their buggy whip partnership early if the buggy whip business becomes unprofitable, or for any other reason. Similarly, if the friendly

83. *See id.* § 31(6).

84. UNIF. P'SHIP ACT § 601(5) (1997) (amended 2013); Robertson v. Jacobs Cattle Co., 830 N.W.2d 191, 201 (2013).

85. *See* Robertson, 830 N.W.2d at 201.

86. UNIF. P'SHIP ACT § 602(b)(2)(ii) (1997) (amended 2013).

87. *See supra* text accompanying notes 48–57.

88. UNIF. P'SHIP ACT § 801(5)(ii) (1997) (amended 2013).

89. *See* UNIF. P'SHIP ACT § 31(1)(c) (1914) (superseded 1992); UNIF. P'SHIP ACT § 801(2)(ii) (1997) (amended 2013).

relationships in a partnership for a term become acrimonious, the partners are not legally required to continue their relationship until the end of the term. They may unanimously agree to end their partnership.

In summary, the distinction between partnerships at will and partnerships for a term is somewhat misleading. If the label "partnership for a term" was taken literally, such a partnership would last until the end of the term. Partners would not be allowed to leave. However, even in partnerships for a term, partners can leave. They can die, express to leave, or be expelled. In these events sometimes the partnership continues without them and sometimes it is liquidated. However, in any event, the partner who has promised to stay in the partnership until the end of the term is allowed to leave. The promise to remain in the partnership is not specifically enforceable. The remedies enforcing the promise are conditional and weak. Therefore, even partnerships for a term are fragile entities because a partner who changes her mind will be allowed to leave.

III. EXIT UNDER CORPORATE LAW

Exit from a corporation is easy if a shareholder can find someone willing to buy her shares. Shares in a corporation are property and freely transferable under default corporate rules.[90] However, what happens if a shareholder wants to leave, but cannot find anyone who wants to purchase the shares? Alternatively, what happens if a shareholder wants to continue to own the shares, but the other shareholders want to force her to sell her shares?

Compared to partnerships, corporations are more stable. If a shareholder expresses the will to leave the corporation, that expression has no effect. If a shareholder dies, her shares pass to her heirs.[91] Management of corporations is more centralized than partnerships. Shareholders elect directors who oversee the management of the corporation.[92] A majority of the directors have great power over most management issues in a corporation.[93] This centralization of management makes the relationships among shareholders less personal than the relationship among partners. For example, partners are general agents of a partnership and can

90. *See* Sandor Petroleum Corp. v. Williams, 321 S.W.2d 614, 617 (Tex. Civ. App. 1959).

91. *See generally*, DEL. CODE ANN. tit. 8, § 159 (2013) ("[t]he shares of stock in every corporation shall be deemed personal property and transferable").

92. *See* TEX. BUS. ORGS. CODE ANN. § 21.361 (West 2009).

93. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 129 (Transaction Publishers 2009).

bind it in contract and tort. Shareholders of a corporation can do neither of these things. Partners in a general partnership are personally liable for the debts of the business. Shareholders are not. Because of the power partners have over the business and each other, partners need to be very concerned about who they are partners with. The fragility of partnerships gives partners the ability to terminate their relationships even in a partnership for a term. Shareholders in corporations do not have this sort of power over each other. Therefore, it is not as important for shareholders to be able to leave a corporation. Shareholders might be stuck with a losing business, but the extent of their loss is limited to their initial investment. However, this limited exposure does not mean that shareholders are stuck with each other with no legal recourse in the event of discord.

Shareholders can petition a court for a dissolution of the corporation or a buyout of their interest.[94] Section 14.30 of the Model Business Corporation Act allows for a judicial dissolution of a corporation in a number of circumstances.[95] A court may order such a dissolution in a proceeding by a shareholder if the directors are acting "in a manner that is illegal, oppressive, or fraudulent."[96] The most expansive of these terms is "oppressive." Oppressive conduct is often interpreted as conduct that violates minority shareholders' reasonable expectations.[97]

> Defining oppressive conduct as distinct from illegality in the present context has been considered in other forums. The question has been resolved by considering oppressive actions to refer to conduct that substantially defeats the "reasonable expectations" held by minority shareholders in committing their capital to the particular enterprise. This concept is consistent with the apparent purpose underlying the provision under review. A shareholder who reasonably expected that ownership in the corporation would entitle him or her to a job, a share of corporate earnings, a place in corporate management, or some other form of security, would be oppressed in a very real sense when others in the corporation seek to defeat those expectations and there exists no effective means of salvaging the investment.[98]

The reasonable expectations test does not fit well in situations where the shareholder did not purchase the shares. If shareholders acquire the shares by gift or bequest, they generally

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94. MODEL BUS. CORP. ACT §§ 14.30(a)(2), 14.34(a) (AM. BAR ASS'N 2010).
95. *Id.* § 14.30 (2010).
96. *Id.* § 14.30 (a)(2)(ii).
97. 12B WILLIAM M. FLETCHER ET AL., FLETCHER'S CYCLOPEDIA OF THE LAW OF CORPORATIONS § 5820.11 (Sept. 2016).
98. Matter of Kemp & Beatley, Inc., 473 N.E.2d 1173, 1179 (1984) (citations omitted).

had no reasonable expectations that motivated their acquisition of the shares.[99] In such cases courts sometimes ask whether the conduct of those in charge of the corporation has been burdensome, harsh, and wrongful.[100] This test inquires into whether those in charge of the corporation have acted with probity and fairness toward the minority shareholders.[101]

If a shareholder who has been oppressed files an action for a court-ordered dissolution, the corporation will not necessarily be dissolved. Under the Model Act, the corporation or the other shareholders can respond to the filing of the petition by purchasing the shares owned by the petitioning shareholder at fair value.[102] Thus an action for judicial dissolution may result in a buyout.

In addition to a shareholder forcing a court-ordered dissolution or buyout, a shareholder may be forced to exit the corporation over her objection. As discussed above, a partner in a partnership may sometimes be expelled by a court-order for various forms of bad behavior.[103] In the corporate context, a shareholder can be forced to give up her shares without any demonstration of bad behavior and without a court-order. Understanding how this can happen requires a basic understanding of merger law. A merger is a statutory device by which two corporations combine into one.[104] In a prototypical merger two separate businesses combine into one, surviving corporation.[105] The assets of the target corporation become assets of the surviving corporation and the shareholders of the target corporation become shareholders of the surviving corporation.[106] However, although a merger requires two corporations, it does not require two actual businesses. Instead, a merger can be created solely for the purpose of getting rid of some of the shareholders.

Merger law allows some of the shares to be eliminated in exchange for cash.[107] This allows some of the shareholders to lose their shares in exchange for the right to receive the cash specified

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99. *See generally* Gimpel v. Bolstein, 477 N.Y.S.2d 1014, 1019 (N.Y. Sup. Ct. 1984).

100. *Id.* at 1018.

101. *See id.* at 1020.

102. MODEL BUS. CORP. ACT § 14.34(a) (AM. BAR ASS'N 2010).

103. *See supra* text accompanying notes 74–88.

104. *Id.* §§ 11.01–11.08. A merger is only one means by which a corporation can acquire the business of another corporation. For example, instead of merging with the target, the acquiring corporation may acquire the target's shares or purchase its assets.

105. *Id.* § 11.02(a).

106. *See* MODEL BUS. CORP. ACT § 11.07 (AM. BAR ASS'N 2010).

107. *See id.* § 11.02(c)(3) ("The plan of merger must include ... the manner and basis of converting the shares of each merging corporation and interests of each merging other entity into shares or other securities, cash, other property, or any combination of the foregoing.").

in the merger agreement.[108] The elimination of these shareholders can be the motivation for the merger. Indeed, one of the merging corporations may have been created solely for the purpose of allowing the merger to take place. An example of this is ***Coggins v. New England Patriots Football Club, Inc.***[109] In that case, William Sullivan, the controlling shareholder of the corporation that owned the New England Patriots, caused a new corporation to be formed.[110] The new corporation had the same directors and officers as the existing corporation.[111] The directors caused both corporations to enter into a merger agreement that provided that the shareholders of the existing corporation, other than Mr. Sullivan, would lose their shares in exchange for the right to receive $15 per share.[112] Therefore, the corporation that existed before the merger and the corporation that existed after the merger were the same, except for the elimination of the minority shareholders. Mr. Sullivan's motive for causing the two corporations to merge was that he needed to use the income of the corporation to pay his own personal debts.[113] This would not have been possible if the other shareholders were around to object to the diversion.[114] The plaintiff, Mr. Coggins, was a shareholder who objected to the merger, which was approved by the shareholders over the dissent of the plaintiff and others. This sort of cash out merger is an example of how merger law can be used to force a shareholder to give up their shares in exchange for cash.

A shareholder who dissents from a cash out merger can sometimes institute an appraisal proceeding to challenge the amount of the payment.[115] However, Mr. Coggins did not merely want to argue about money, he wanted to keep his shares. When Mr. Sullivan originally caused the corporation to offer shares to the public he wanted to raise money and encourage fans to bond with his new team.[116] Some years later, Mr. Coggins, who was serving in Vietnam, had his brother purchase the shares on his behalf and formed the bond that Mr. Sullivan originally wanted to encourage.[117] To him a transaction that was intended to eliminate his interest was not merely a matter of money. The court agreed

108. *See id.*
109. *See* Coggins v. New Eng. Patriots Football Club, 492 N.E.2d 1112, 1115 (Mass. 1986).
110. *Id.*
111. *Id.*
112. *Id.*
113. *See id.* at 1115 n.6.
114. *See id.* at 1115.
115. MODEL BUS. CORP. ACT §§ 13.01–13.03 (AM. BAR ASS'N 2010).
116. *See* Coggins, 492 N.E.2d at 1115 n.8.
117. *See id.* at 1115.

with him. The court held that a transaction that eliminated shareholders solely to advance the personal interests of the controlling shareholder was illegal.[118] The court held that at a minimum a merger must serve some business purpose for the corporation.[119] This business purpose requirement is not universally accepted. Delaware rejects this requirement.[120] Instead, Delaware imposes a more general fair dealing and fair price requirement.[121]

So far this section has discussed three ways a shareholder may exit a corporation. The most common, least controversial is that a shareholder may voluntarily sell her shares to a willing buyer. Second, a shareholder may force a court-ordered dissolution or buyout. Third, a shareholder may have her shares taken from her in a cash out merger. In addition to these three ways, a shareholder may exit a corporation if the corporation is dissolved pursuant to a vote of the board of directors and the shareholders. Both the Model Act and the Delaware statute provide for the dissolution of the corporation on the majority vote of the directors and the shareholders.[122] These rules are in accord with the general director centric, majority centric approach of corporate law. Under these rules, a majority of the directors and shareholders can decide that the corporation should dissolve. In a dissolution, all of the shareholders exit, even if some of them would prefer that the corporation continue and that their interest in it remain intact. On their face, these rules might seem to mean that corporations are less stable than partnerships. At least in a partnership for a term, a voluntary dissolution requires that all partners vote for the dissolution rather than a mere majority.[123] However, it is important to remember that, even in a partnership for a term, partners have the power to exit wrongfully before the end of the term.[124] Further, sometimes these wrongful exits lead to dissolutions depending on the actions of the other partners.[125] Therefore, even in a partnership for a term exit can occur at the whim of a single partner.

In summary, corporations are relatively stable compared to partnerships. Although shareholders can voluntarily sell their shares, this depends on finding a willing buyer. Court-ordered

118. *See id.* at 1118–19.

119. *See id.* at 1122.

120. Weinberger v. UOP, Inc., 457 A.2d 701, 715 (Del. 1983).

121. *Id.* at 711.

122. DEL. CODE ANN. tit. 8, § 275 (2013); MODEL BUS. CORP. ACT §§ 7.25, 8.24, 14.02 (AM. BAR ASS'N 2010).

123. *See supra* text accompanying note 89.

124. *See supra* text accompanying notes 34–56.

125. *See supra* text accompanying notes 58–62.

dissolutions and buyouts are possible under the Model Act, but depend on a court finding oppression. Cash out mergers can force a shareholder to exit, but depend on board and shareholder approval of the merger, and sometimes the demonstration of a corporate purpose for the merger. It is always possible that the corporation may voluntarily dissolve. However, that depends on majority approval by the board and the shareholders, in accord with the director centric and majority centric nature of corporate law.

IV. EXIT UNDER LIMITED LIABILITY COMPANY LAW[126]

Exit from a limited liability company is a hybrid of concepts of partnership law and corporate law.[127] As to voluntary sales of a member's interest in an LLC, a member's interest is nominally assignable.[128] However, such a transfer does not make the buyer a member of the LLC.[129] Instead, the assignee has the right to receive any financial distribution that the assignor would have received.[130] The assignment may or may not cause the assignor to cease being a member.[131] All of this is in contrast to the sale of shares in a corporation which causes the buyer to acquire all of the rights of the seller.

Expression by a member of an LLC to leave the entity does not entitle the member to a buyout of her interest under either the Uniform Act or the Delaware act. The Uniform Act does provide that a member may dissociate by expression.[132] However, the member's dissociation does not require the LLC to purchase the member's interest.[133] Instead, the member's right to participate in management ends, her fiduciary duty as a member as to

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126. Although the law of limited liability companies is highly variable, this section will focus on the Uniform Limited Liability Company Act (2006) and the Delaware Limited Liability Company Act.

127. *See generally* Joan MacLeod Heminway, *The Death of an LLC: What's Trending in LLC Dissolution Law?*, BUS. L. TODAY, January 2016, at 1, http://www.americanbar.org/content/dam/aba/publications/blt/2016/01/death-llc-201601.authcheckdam.pdf [http://perma.cc/FF5R-7KDM]; Joan MacLeod Heminway, *Fundamental Changes in the LLC: A Study in Path-Divergence and Convergence, in* RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS 189 (Robert W. Hillman & Mark J. Loewenstein eds. 2015).

128. UNIF. LTD. LIAB. CO. ACT § 502(a)(1) (2013); DEL. CODE ANN. tit. 6, § 18-702(a) (2013).

129. UNIF. LTD. LIAB. CO. ACT § 502(a)(3)(a) (2013); DEL. CODE ANN. tit. 6, § 18-702(b)(1) (2013).

130. DEL. CODE ANN. tit. 6, § 18-702(b)(2) (2013); UNIF. LTD. LIAB. CO. ACT § 502(b) (2013).

131. *Compare* DEL. CODE ANN. tit. 6, § 18-702(b)(3) (2013), *with* UNIF. LTD. LIAB. CO. ACT § 502(a)(2) (2013).

132. UNIF. LTD. LIAB. CO. ACT §§ 601(a), 602(1) (2013).

133. *See id.* § 502(b).

subsequent actions ends, and she is treated as a transferee of the financial rights she had as a member.[134] So, the expression of the will to leave causes the member to exit the LLC, but does not get her anything with respect to her membership unless a distribution is subsequently made by the company.[135] The Delaware act is much more straightforward. It provides simply that a member may not resign from an LLC unless the limited liability company agreement says she can.[136] If the agreement says a member may resign, the resigning member is entitled to a payment of the fair value of her interest.[137]

A disgruntled member of an LLC may be able to force a judicial dissolution of the company and obtain payment for her interest that way. The Uniform Act allows a court to order a dissolution of an LLC on the application of a member if "it is not reasonably practicable to carry on the company's activities and affairs in conformity with the certificate of organization and the operating agreement."[138] The Uniform Act also allows the court to order the dissolution if those in control of the company are behaving in a "manner that is oppressive and ... directly harmful to the applicant."[139] In the latter situation, the statute allows the court to "order a remedy other than dissolution."[140] This allows the court to order a buyout instead of a dissolution. The Delaware act does not provide for judicial dissolution for oppression but does provide that a court "may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement."[141]

A dissolution of an LLC may also occur by the collective action of its members. The Delaware act provides for the voluntary dissolution of an LLC on the affirmative vote of members owning two thirds of the financial interest in the company.[142] The Uniform

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134. *Id.* § 603; Daniel S. Kleinberger & Carter G. Bishop, *The Next Generation: The Revised Uniform Limited Liability Company Act,* 62 BUS. LAW. 515, 543 (2007).

135. Larry E. Ribstein & Robert R. Keatinge, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES, § 11.2 & n.4 (2016) (explaining that a provision treating a dissociating member as a mere transferee of their own interest "is sometimes referred to as a 'Hotel California' provision because the Member may check out at any time but may never leave").

136. DEL. CODE ANN. tit. 6, § 18-603 (2013).

137. *Id.* § 18-604.

138. UNIF. LTD. LIAB. CO. ACT § 701(a)(4)(B) (2013).

139. *Id.* § 701(a)(4)(C)(ii).

140. *Id.* § 701(b).

141. DEL. CODE ANN. tit. 6, § 18-802 (2013).

142. DEL. CODE ANN. tit. 6, § 18-801(a)(3) (2013).

Act provides that an LLC may be dissolved on the unanimous vote of the members.[143]

V. THE RELATIONSHIP OF RIGHTS AND REMEDIES

The foregoing discussion of the right of an individual owner or a group of owners to exit a business entity demonstrates the importance of the relationship of rights to remedies. An owner or group of owners may not have the right to exit an entity, however the remedies to enforce the continued relationship of the owners may be strong or weak. An obligation to continue as owner that is enforced by a strong remedy keeps the business entity intact. Such an obligation enforced by a weak remedy makes the entity more fragile.

An example of an obligation to remain part of an entity supported by a strong remedy arises in corporate law. When a shareholder buys stock in a corporation, she is not entitled to exit the corporation.[144] She can sell her stock to a willing buyer (which could include the corporation itself).[145] However, if she cannot find a willing buyer, she cannot exit the entity unless she can meet the stringent standards for a court-ordered dissolution or buyout.[146] Her continued participation in the entity is self-enforcing. Substantively, this outcome is not troubling. Her financial exposure is limited to the amount she paid for the shares. She owes no duties to the entity or her fellow shareholders, other than to pay this amount.[147] Her fellow shareholders do not have agency authority to bind her or the entity. She knew going in that management would be centralized in the board of directors.

An example of an obligation to remain part of an entity supported by weak remedies is a partnership for a term or an undertaking. First, this obligation arises only when the partners have at least impliedly agreed to accept it.[148] Without such an agreement, the partnership is at will and the partners can force a dissolution and liquidation by merely expressing the will to exit the partnership.[149] If the partners have agreed to a term, they do

143. *See* UNIF. LTD. LIAB. CO. ACT § 701(a)(2) (2013).

144. Mihaela Gherghe, Raluca Papdima, & Radu Valeanu, *Shareholder Exit Signs on US and EU Highways*, U. PA. J. BUS. L. (forthcoming) (manuscript at 3), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2663180 (last visited Aug. 27, 2016) [http://perma.cc/6AMQ-9NFT].

145. *See id.* (manuscript at 3–4).

146. *See, e.g.*, Bogosian v. Woloohojian Realty Corp., 923 F.2d 898, 898–900 (5th Cir. 1991).

147. *See* David A. Hoffman, *The "Duty" to Be a Rational Shareholder*, 90 MINN. L. REV. 537, 537–38 (2006).

148. *See* Tropeano v. Dorman, 441 F.3d 69, 76 (1st Cir. 2006).

149. *Id.*

not have the right to exit the entity. However, this obligation to remain partners is enforced with weak remedies. This obligation is not specifically enforceable with injunctive relief. The exiting partner must pay damages caused by her exit. However, in some situations these damages would be small or nonexistent. Under the Uniform Partnership Act (1914), the exiting partner is required to wait for payment until the end of the term, however she can elect between interest or profits as compensation for the delayed payment.[150] Under the Uniform Partnership Act (1997), the exiting partner receives only interest for the period of the delayed payment, but can get paid before the end of the term if she can show that the partnership will suffer no undue hardship.[151] If the partnership does delay payment, it must provide security.[152] Under the Uniform Partnership Act (1914), that security must take the extraordinary form of a court-approved bond.[153] Therefore, as a practical matter, a partner who has promised to stay for a term can exit the partnership and in some cases pay little or no damages. Further, she can sometimes get bought out before the end of the term.

The obligation of a partner to remain until the end of the term is further weakened by its conditional nature. If one partner exits the partnership early, the other partners have the right to exit without paying damages or facing a delayed payment. Under the Uniform Partnership Act (1914), a partner who wants to exit following the exit of another partner can simply withhold consent to the continuation of the partnership.[154] This will force the dissolution of the partnership. Under the Uniform Partnership Act (1997), such a subsequently exiting partner can express the will to exit within ninety days of the earlier exit and receive a buyout of her interest.[155] If half of the remaining partners do so, the partnership will be dissolved.[156] Thus, the commitment of a partner to remain in the entity until the end of the agreed upon term can sometimes be of little practical importance because of the weak remedies supporting it and its significantly conditional nature.

The obligation to remain in a limited liability company is more similar to corporate law than to partnership law. First, these obligations arise as a matter of default and do not require an

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150. *E.g.*, Gull v. Van Epps, 517 N.W.2d 531, 533–34 (Wis. Ct. App. 1994).
151. Brennan v. Brennan Assocs., 113 A.3d 957, 967 (Conn. 2015).
152. UNIF. P'SHIP ACT § 701(h) (1997) (amended 2013).
153. UNIF. P'SHIP ACT § 38(2)(b) (1914) (superseded 1992).
154. *See id.* § 38(2)(a)(I).
155. UNIF. P'SHIP ACT §§ 602(b)(2)(A), 701(a) (1997) (amended 2013).
156. *Id.* § 801(2)(A).

agreement to remain for a term. Second, these obligations are self-enforcing. In Delaware, an expression of a desire to exit is ineffective. The member remains in the entity despite the expression. Under the Uniform Act, an expression of a desire to exit causes a dissociation of the member from the entity. However, the former member is then treated as a transferee of her own interest. She does not have the right to force a buyout of her interest or the dissolution of the LLC absent a court-order. Further, unlike a partnership for a term, there is no set date in the future when a payment would be made to the member. The member could have her capital stuck in the entity forever.

The varying standards for individual exit from a business entity make the standards for collective exit crucial.

VI. THE RELATIONSHIP OF INDIVIDUAL EXIT TO COLLECTIVE EXIT

As discussed in the prior section, the practical effect of an obligation to remain part of a business entity is a product of right and remedy. The obligation to remain in a corporation or a limited liability company is of significant practical effect because this obligation is supported by a strong, self-enforcing remedy. This obligation also arises as a matter of default, without an express or implied agreement of the parties and is not significantly conditional. In contrast, in a partnership, an obligation to remain in the entity arises only as the result of an agreement, is significantly conditional and is supported by weak remedies.[157] In addition to the relationship of right to remedy, the relationship of individual exit to collective exit is important.

In a corporation, individual owners have no right to elect to exit the corporation.[158] However, collectively, a group of owners can force an exit in the form of a voluntary dissolution of the corporation.[159] In general, management of a corporation is director centric and majority centric. It is director centric since most business decisions are made under the direction of the board of directors.[160] It is majority centric since the majority of the shares elect the directors.[161] The law governing the dissolution of a corporation is consistent with this approach since a voluntary dissolution must be recommended by the board of directors and

157. *See* Robert W. Hillman, *The Impact of Partnership on the Legal Profession*, 67 FORDHAM L.R. 393, 404 (1998).

158. *See* Gherghe, Papdima, & Valeanu, *supra* note 144, at 6.

159. *See* MODEL BUS. CORP. ACT § 14.02 (AM. BAR ASS'N 2010).

160. *E.g.*, Shoen v. SAC Holding Corp., 137 P.3d 1171, 1178 (Nev. 2006).

161. Standard Power & Light Corp. v. Inv. Assocs., Inc., 51 A.2d 572, 576 (Del. 1947) ("Outstanding among the democratic processes concerning corporate elections is the general rule that a majority of the votes cast at a stockholders' meeting ... is sufficient to elect Directors.").

approved by holders of a majority of the shares. If holders of a majority of the shares want to dissolve, they can elect a board that will recommend the dissolution and then the majority shares can vote to approve this recommendation.[162] Minority shareholders who want the corporation to continue do not have the power to block this action. Therefore, the default deal among owners of a corporation is that individual owners have few rights to govern or to exit. However, owners of a majority of the shares can elect directors who govern and who, with the owners of a majority of the shares, can cause a dissolution.

In a partnership, individual owners have greater ability to exit because an obligation to remain for a term arises only by agreement, is significantly conditional, and is supported by weak remedies. However, a majority of owners in a partnership for a term, cannot force a dissolution unless at least one partner exits first. Absent such an initial exit, a dissolution would require unanimous consent of the partners. Therefore, individual exit is easy, but collective rightful exit is difficult.

In a Delaware LLC individual exit is difficult, but collective exit is moderately easy. An expression by a member of the will to withdraw from the entity has no legal effect, unless such exit is allowed by the operating agreement.[163] The expressing member continues as part of the entity. Collective action seeking the dissolution of the entity is harder than in a corporation, but easier than in a partnership for a term. It takes owners of two-thirds of the financial interest in the LLC to force a dissolution. Thus, although individual exit is prohibited, members holding a super majority of the financial interest may force a liquidation of the firm over the objection of the remaining members.

In an LLC formed under the Uniform Act, both individual exit and collective exit are difficult. Although the Uniform Act allows individual members to dissociate by expressing the will to leave, the dissociated member has no right to force a buyout of her interest. The dissociated member is treated as a transferee of her own interest. She will receive any distribution of profits that the entity chooses to make, but has no management rights or rights to force a buyout or dissolution.[164] Therefore, although the member has technically exited the entity, she remains an investor without the right to participate in management. This status goes on indefinitely. Collective exit is also difficult. A voluntary dissolution of an LLC under the Uniform Act requires the unanimous consent

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162. *See generally* MODEL BUS. CORP. ACT § 14.02 (AM. BAR ASS'N 2010).

163. If the operating agreement allows such exit the entity must repurchase the members interest for fair value. DEL. CODE ANN. tit. 6, § 18-604 (2013).

164. *See* UNIF. LTD. LIAB. CO. ACT § 502 (2013).

of the members.[165] Even members owning a super majority of the financial interest in the LLC may not force a dissolution. Therefore, both individual exit and collective exit are difficult since the obligation to remain invested in the entity arises as a matter of default, is not significantly conditional, is enforced by strong, self-enforcing remedies and is not subject to override by a majority of owners short of unanimity.

VII. CHOOSING EXIT NORMS FACED WITH BOUNDED RATIONALITY

Exit from a business entity is one form of mid-term adaptation to changed circumstances. As the time since the initial formation of a business entity lengthens, the likelihood that one or more owners will seek an adaptation increases. At the inception of a business relationship the parties anticipate various possible future circumstances. Some of these circumstances are driven by facts external to the business. These include the demand for the firm's products and services, the cost of labor and other inputs consumed by the firm, and the legal environment in which the firm operates. Other future circumstances are internal to the firm. These include which of the co-owners will agree with each other about how the firm should adapt to changed external circumstances.

Many forms of mid-term adaptation to changed external circumstances do not involve exit from the firm. The firm can change how it operates its business. It can change its mix of products, including leaving the field in which the owners originally planned on operating and entering completely new fields. Less dramatically, the firm can change locations, own rather than rent its facilities, outsource activities previously done by its employees, and borrow money. These forms of adaptation to external circumstances involve potentially changing circumstances internal to the firm. The co-owners may disagree about how the firm should respond to external circumstances. As a matter of default, on operational matters firms are to varying degrees governed by majorities. Ordinary business decisions in a partnership are governed by a majority vote of the partners, with each partner having one vote.[166] Extraordinary decisions require the unanimous consent of the partners.[167] In a corporation, business decisions are controlled by the board of directors.[168] The shareholders do not have direct control of the corporation, rather

165. *Id.* § 701(a)(2).
166. UNIF. P'SHIP ACT § 401(j) (1997) (amended 2013).
167. *Id.*
168. *See, e.g.*, MODEL BUS. CORP. ACT § 8.01(b) (AM. BAR ASS'N 2010).

the shareholders elect the directors.[169] However, unlike a partnership, shareholders do not merely possess one vote each. Rather, shareholders with more shares have more votes. A single shareholder out of many, may control a majority of the votes and elect a majority (or all) of the directors.[170] In an LLC, management norms will depend on whether the firm is managed by its members or managed by one or more managers. Member managed LLCs are managed similar to partnerships.[171] Manager managed LLCs are managed by the manager or managers.[172] These varying forms of majoritarian control determine how the entity will adapt to changed external circumstances. Conflict about how the firm should adapt to changed external circumstances can lead to the desire on the part of at least some co-owners to exit the entity.

At the time a business entity is created, the owners often do not know two things about future circumstances internal to the entity. First, they do not know whether in a future dispute among the owners they will be in the majority or the minority. Because the default voting arrangement among partners is one vote per partner, a single partner does not know who will agree with her in the future. Groups of partners can repeatedly shift, depending on the question presented to the partnership. Predicting these shifting alliances years in advance is impossible. The same is often true among members in a member managed LLC. In a corporation, shifting patterns of control are more complex. Members of the board of directors can be elected and usually removed without cause by shareholders.[173] Therefore, the owner of a majority of shares has practical control over the business decisions in a corporation. However, it is not always possible to predict who will be the majority shareholder. Although a single shareholder may own a majority of the shares when the corporation is formed, future issuances of new shares may dilute the votes of the original majority shareholder. Several factors affect the ability of the initial majority shareholder to protect their majority. If the articles of incorporation authorize only the shares originally issued, issuing more shares in the future would require amending the articles. The majority shareholder may prevent this. Even if

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169. *See, e.g.*, *id.* § 8.03(c).

170. Candidates for election to the board of directors who receive the most votes are elected. *Id.* § 7.28(a). Therefore, a shareholder holding a majority of the shares can elect the entire board. However, if the corporation allows cumulative voting, shareholders may "stack up" their votes on one or more candidates. *Id.* § 7.28(c). This will sometimes allow a minority shareholder to prevent a majority shareholder from electing the entire board.

171. *See, e.g.*, UNIF. LTD. LIAB. CO. ACT § 407(b) (2013).

172. *See, e.g.*, *id.* § 407(c).

173. Members of a staggered board are removable only for cause in Delaware. DEL. CODE ANN. tit. 8, § 141(k)(1) (2013).

the articles authorize more shares than those originally issued, issuance of new shares would require the approval of the board of directors. This approval is of course subject to the influence of the majority shareholder. Further, at the time of the future issuance, the existing shareholders may have preemptive rights to purchase some of the newly issued shares. However, even if the initial majority shareholder has such protections, the initial majority may break down. When the shareholder dies, her shares may be inherited by more than one person, none of whom own a majority. If the shareholder gets divorced, the shares may be divided among the former spouses similarly splitting the majority. If the shareholder cannot pay her debts, her creditors may execute on some or all of the shares for payment of the debts. Thus, in any form of business enterprise the question of which owners will control business decisions in the future is not certain.

The second factor of uncertainty at inception about future circumstances internal to the entity is whether a particular owner or group of owners will want to exit the entity. As discussed in the prior section, exit can involve ending the business entity by voluntary dissolution, or can involve exit by one or more owners while the entity continues. Either of these can arise as a result of a dispute among the owners about how the business should be run, including how it should respond to changed external circumstances. Therefore, the uncertainty about whether a particular co-owner will be in the majority or the minority on a question of business operations is conceptually connected to whether one or more co-owners will want to exit. However, an exit by some owners or a voluntary dissolution can also result without such a dispute. Some or all of the owners may just want to withdraw their capital and redeploy it to other uses. They may want to invest in another business, or may just want to spend their money on personal expenditures. In either situation rules governing exit will come into play. Of course, some of those rules favor majorities and some favor individual co-owners.

The uncertainty about whether a particular co-owner will be in the majority or the minority, and the uncertainty about whether a particular co-owner will want an individual exit or a voluntary dissolution combine in assessing what is the optimal rule for exit. Under partnership norms, management rules about operations favor the majority. However, exit rules favor the individual co-owner. In a partnership at will, an individual partner can force a dissolution and winding up. In a partnership for a term, an individual partner can exit the partnership, and in some cases force a quick buyout. In any case the exiting partner will at least be paid at the end of term and will be compensated for any delay in payment. Therefore, at the inception of the partnership an individual partner will know that if they are in the majority, they will have management control, and if they are not they will have the ability to exit. However, they also know that if they are in the majority, they may face the dislocations that come from having to deal with another partner exiting the partnership.[174]

To avoid the possibility of having to deal with another co-owner's untimely exit, a group of co-owners may choose corporate norms. These norms favor the owners of the majority of the shares, both on operational questions and on exit issues. On operational issues the holder of the majority of the shares elects the directors and the directors manage the business. On exit issues, the majority can choose whether or not the corporation will voluntarily dissolve.[175] Individual exit is not a matter of right and court ordered dissolutions are often difficult. In choosing these majoritarian norms an individual co-owner may be betting that they will be in the majority in the future. They may also believe that risk of dislocations caused by the easy minority exit of partnership norms outweighs the risk of being in the minority under corporate norms. The comparison of partnership and corporate norms offers co-owners a menu of alternatives about which risks they want to take.

The ULLCA default rules for management and exit offer a different set of risks for co-owners. However, they are substantially less attractive than either partnership or corporate norms. ULLCA management norms are similar to partnership norms or corporate norms, depending on whether the LLC is member managed or manager managed. In either case, they are majoritarian in nature. However, the exit norms under the ULLCA are unlike either partnership or corporate norms. Under the ULLCA, individual exit is difficult since expression leads to the member being treated as a transferee of her own interest and potentially waiting forever for a buyout unless she can obtain a court-ordered dissolution. However, voluntary dissolution is impossible without a unanimous vote of the members. Therefore, paradoxically, an individual member may not manage the business, nor may she effectively withdraw her capital from the LLC, but may successfully prevent the voluntary dissolution of the entity. The exit norms under the ULLCA do not favor the majority or the minority if they are seeking an exit. Rather, they favor the owners who want the entity to continue whether they are in the

174. *See* Alan R. Bromberg & Larry E. Ribstein, 2 BROMBERG AND RIBSTEIN ON PARTNERSHIP, §7.02(d) (2014) (discussing the disadvantages of easy exit in a partnership).

175. Delaware LLC law is conceptually similar to this, with the two-thirds voting requirement for a voluntary dissolution somewhat altering the calculus. DEL. CODE ANN. tit. 6, § 18-801(a)(3) (2013).

majority or the minority. While operational adaptations are allowed at the behest of the majority, adaptation by exit is denied both to the individual members and to a majority of members in the absence of unanimity or a court-order. This does not seem like a set of risks that most co-owners would pick ex ante.

One way of analyzing these varying bundles of risk and reward is to look at them from the ex ante perspective of a potential investor in a new business entity. When considering a corporate form, the investor would see that there is the upside potential of being in the majority. In the corporate majority, she would be able to make operational decisions and not face the costs of easy exit by her co-owners. In the majority, she would also be able to cause a voluntary dissolution if she wanted one. However, she would also know that in the future she might end up in the minority. In which case she would be stuck in a business entity being managed in a way with which she disagrees.

Alternatively she might choose partnership norms. In a partnership there is still the upside potential of being in the majority. There she would control the operational decisions. However, she would face the potential costs of dealing with the exit of partners who disagree with her management decisions. Even in a partnership for a term, these costs could be substantial. Indeed, if these dissenting partners exit in a particular sequence, the partnership may dissolve. Therefore, the upside potential of being in the majority is not as great as in the corporate setting. However, in a partnership the downside potential of being in the minority is also moderated by those very same easier exit aspects of partnership norms.

If she chooses to invest in a LLC formed under the ULLCA, the upside potential of being in the majority still includes operational control of ordinary business decisions. Like corporate norms, it also includes the ability to avoid the costs of easy exit by dissenting minority owners. However, unlike corporate norms, this upside potential of being in the majority does not include the ability to cause a voluntary dissolution since under the ULLCA, a unanimous vote of the members is required for a voluntary dissolution.[176] When considering the downside potential of being in the minority, the potential investor in a LLC formed under the ULLCA would be stuck in an entity being managed in a way with which she disagrees. Therefore, such an investment has the

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176. Not all jurisdictions enacting the ULLCA have adopted the unanimity requirement. In California, for example, a limited liability company may be dissolved by "the vote of a majority of the members of the limited liability company or a greater percentage of the voting interests of members as may be specified in the articles of organization, or a written operating agreement." CAL. CORP. CODE § 17707.01(b) (West 2016).

downside of investing in a corporation, without all of the potential upside. If she ends up in the minority she is stuck without easy exit. If she ends up in the majority she cannot force a voluntary dissolution. Indeed, she might end up in the minority on operational questions, but in a very large majority on the question of whether the LLC should voluntarily dissolve. However, if this majority is short of unanimity, the voluntary dissolution is impossible. This particular combination of risk and reward does not seem very attractive.

VIII. CONCLUSION

Rules governing exit from different types of business entities are a complex combination of rights and remedies. Exit by individual owners may be easy or difficult. Exit may lead to dissolution of the entity or continuation of the entity with a buyout of the exiting owner. Collective exit by a majority is sometimes a vehicle to force a voluntary dissolution. Potential investors in a new entity face bounded rationality about whether they will be in the minority or majority about operational questions and disputes about whether the entity will voluntarily dissolve. They also face bounded rationality about whether they will be the one seeking an exit. Faced with this set of uncertainties, corporate norms and partnership norms offer different bundles of risk and rewards. The exit rules under the ULLCA offer neither the benefits of corporate norms to the majority nor the benefits of partnership norms to the minority.