

TO WHOM IT MAY CONCERN:
FIDUCIARY DUTIES AND BUSINESS ASSOCIATIONS

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ABSTRACT

Managers of business associations, whether they are partners, corporate directors, or member-managers of limited liability companies, are charged with fiduciary duties. The beneficiaries of those duties, however, are not well defined. If a fiduciary is required to act in the best interests of her beneficiary, she must understand not only who the beneficiary is, but also what the beneficiary's interests are. This fundamental problem permeates fiduciary law and yet remains unaddressed in any systematic way. In this article, Professor Dalley develops a theory regarding business associations that identifies such associations as purposive groups. Drawing on the literature of philosophy, sociology and social psychology, Professor Dalley argues that business associations are created and identified by the common purpose for which they were constituted, and that a manager's role is to advance such purpose. This understanding of business associations explains the existing laws of fiduciary duties and provides guidance to managers and to courts for assessing the managers' acts.

[T]o say that a man is a fiduciary only begins [the] analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations?¹

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¹SEC v. Cheney Corp., 318 U.S. 80, 85-86 (1943) (Frankfurter, J.).

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I. INTRODUCTION

The scholarly literature relating to business associations (partnerships, corporations, and limited liability companies (LLCs)) frequently refers to fiduciary duties. A majority of the contested issues in business law scholarship today relate to fiduciary duties: do corporate officers and directors owe fiduciary duties only to their shareholders, or also to employees, creditors, customers, and the community at large? Was it a mistake for the revised Uniform Partnership Act (RUPA)² to make certain features of partners' fiduciary duties non-waivable? Are fiduciary duties justified as a standard-form contract term that the parties would agree to (because it is an efficient way to reduce the need to monitor agents and other

²REVISED UNIFORM PARTNERSHIP ACT § 401 cmt. 1 (1997), 6 U.L.A. 74 (Supp. 2000) [hereinafter RUPA].

representatives),³ or are they an obligation based in morality, justified as a way to encourage virtuous behavior?

The scholarly literature does not, however, seek to define the breach of fiduciary duty. Scholarly commentators generally ignore the question entirely, while the treatises rely upon a list of specific acts that have been found in the past to constitute breaches of duty, quotations, and dicta from the case law that are more noteworthy for their rhetorical value than for any legal merit. The courts, presumably guided by the arguments of counsel, in the absence of useful academic literature, have developed an impressive body of opinions that, while correct, have generally failed to articulate the principles underlying their rulings and have relied instead on rhetoric, frequently with moral overtones. The lack of a unifying principle in the case law has resulted in a lack of guidance to courts and commentators that are considering difficult applications of the law of fiduciary duty.

Identifying a breach of fiduciary duty necessarily involves identifying to whom the duties are owed. This is oftentimes the difficult question to be answered with regard to business associations.

Example 1: XYZ Corp., a large company with many shareholders, manufactures and sells wooden furniture. One day, Xavier, the President of XYZ, is offered an opportunity to invest in an online music shopping service. If he takes the opportunity, he has not breached his fiduciary duty to XYZ, because the opportunity is not within the corporation's business area.

Example 2: The same facts as example 1, above, except that the online shopping service competes directly with a service owned by Yolanda, an XYZ shareholder. Xavier has not breached a fiduciary duty to Yolanda, because he does not owe a duty directly to the shareholders of XYZ.

Example 3: Donna and Roger form a partnership to practice medicine. One night, Donna breaks into Roger's home and steals his new television. Donna *may* have breached her fiduciary duty to Roger as her partner, even though her act had nothing to do with the partnership business, because the law provides that partners owe duties to each other, and there is

³See Thomas A. Smith, *The Efficient Norm For Corporate Law: A Neotraditional Interpretation of Fiduciary Duty*, 98 MICH. L. REV. 214, 217, 235 (1999).

authority for the proposition that those duties are not limited to acts involving the partnership's business.⁴

As these examples illustrate, identification of the beneficiary of fiduciary duties requires a coherent understanding of the nature of the business association in question.

This article seeks to clarify the law of fiduciary duties and provide a coherent set of principles for determining when breaches of duty have occurred by exploring the nature of business associations as special kinds of groups.⁵ Business associations, whether the law treats them as legal entities or not, are groups with special characteristics. Although the law has largely ignored this fact, philosophy, sociology, and social psychology have not, and the insights of those disciplines cannot only advance our understanding of business associations generally, but can also help to explain why certain acts constitute breaches of the fiduciary duty owed by representatives of associations (such as partners or corporate officers), while other acts do not. Breaches of duty occur when a representative takes an action that is not in the interest of the association. If the act is in the representative's or someone else's interest, rather than in the interest of the association, the act is a breach of the duty of loyalty, whereas if the act is merely negligent, it is a breach of the duty of care. If the act results in the withholding of relevant information, however, it is a breach of the duty to disclose.⁶

Because a breach of fiduciary duty involves, at the first level of analysis, an act that is not in the interest of the association, the law must provide both an understanding of the identity of the association and a means of identifying its interests. The association is a group formed for a specific purpose; to operate a business in a cooperative manner. The nature of the cooperation will differ from group to group. For example, a large

⁴For a brief discussion of the question "to whom do partners owe their duties?," see 2 ALAN BROMBERG & LARRY RIBSTEIN, *BROMBERG & RIBSTEIN PARTNERSHIPS* § 6.07(a)(6) (1996).

⁵For a somewhat similar analysis using economic, rather than psycho-sociological, models, see Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999), who argue that

a public corporation is a team of people who enter into a complex agreement to work together for their mutual gain. Participants – including shareholders, employees, and perhaps other stakeholders such as creditors or the local community – enter into a '*pactum subjectionis*' under which they yield control over outputs and key inputs . . . to the hierarchy. . . . They thus agree not to specific terms or outcomes (as in a traditional "contract"), but to participation in a process of internal goal setting and dispute resolution.

Id. at 278 (citations omitted).

⁶Certain acts may constitute breaches of the obligation of good faith and fair dealing that is implied in all contracts, including partnership agreements and other contracts relevant to business associations. That obligation is not a fiduciary duty, however. See Paula J. Dalley, *The Law of Partner Expulsions: Fiduciary Duty and Good Faith*, 21 CARDOZO L. REV. 181, 183 (1999).

corporation is cooperative only to the extent that the assets of the shareholders are pooled to provide capital for a large enterprise, whereas a small partnership or close corporation is usually cooperative in a much broader sense, with the participants expecting to assist each other in the conduct of their business and, in some instances, to support each other in other ways. The business in question will of course be defined by the group itself, subject to amendment over time. The purpose of the group and its interests are articulated in two ways: by the original agreement of its founders and by subsequent acts of its members and by its managers or "organ"⁷ who are empowered to speak on the group's behalf.

This article explores the nature of business associations as special groups and the processes that serve to identify the interests of those groups and thereby seeks to provide a coherent explanation of the law concerning breaches of fiduciary duty. Part II summarizes the current law of fiduciary duties in partnership and corporation law. Part III explores the nature of business associations: (a) the aggregate and entity understandings of the partnership, which in fact differ very little, and (b) the theories of corporate personality that have been debated over the last 120 years. Part IV first describes the findings of group theory in other disciplines and uses that theory to provide a better understanding of the nature of business associations, and explores the means by which the interests of groups can be identified. Finally, Part V concludes with a review of the utility and value that an understanding of group theory provides in explaining and clarifying the principles of fiduciary duty law described in Part II.

II. FIDUCIARY DUTIES UNDER CURRENT LAW

Fiduciary duties generally fall into three categories: the duty of care, the duty of loyalty, and the duty to disclose. Beyond that, however, it is difficult to find a useful or coherent statement of the law. Judge Cardozo's rhetoric in *Meinhard v. Salmon*⁸ is frequently quoted:

Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has

⁷This term, used by Otto von Gierke and other group theorists, refers to the individual or body empowered, usually by democratic election, to speak for the group. See Otto von Gierke, *The Nature of Human Associations* (John D. Lewis trans.), in JOHN D. LEWIS, *THE GENOSSENSCHAFT-THEORY OF OTTO VON GIERKE* 139, 153 (1935).

⁸164 N.E. 545 (N.Y. 1928).

developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.⁹

In terms of case law, however, the courts are not so clear. Corporate law developed the business judgment rule, which essentially shields corporate officers and directors from liability for mere negligence,¹⁰ and courts have applied a similar rule to partners in recent years.¹¹ Additionally, courts applying the duty to disclose to partnerships¹² and corporations¹³ have generally adopted a materiality standard borrowed from the law of fraud and securities, despite the fact that an agent's duty to disclose relates to all matters regarding to his agency, whether material or not.¹⁴ Most reported fiduciary duty cases involve the duty of loyalty. The *Restatement of Agency* includes among the specifics required by the duty of loyalty, the duty not to compete with the principal, not to profit from the agency relationship, not to act adversely to the principal or on behalf of an adverse party in a transaction with the principal, and not to use or disclose the principal's confidential information. As discussed below, the primary issue in many duty of loyalty cases is the scope of the duty, which in turn depends upon to whom the duty is actually owed.

A. Partnerships

At common law, and under the original Uniform Partnership Act (the UPA),¹⁵ partners' fiduciary duties applied only to matters relating to the

⁹*Id.* at 546 (citations omitted).

¹⁰The business judgment rule protects managers from suits alleging breach of the fiduciary duty of care by presuming that a corporate action is taken "in the honest belief that [it] was in the best interests of the company." *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). Alternatively, the rule can be viewed as a lowered standard of review of directors' acts. See WILLIAM L. CARY & MELVIN ARON EISENBERG, *CASES AND MATERIALS ON CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS* 602-05 (7th ed. unabridged 1995).

¹¹See BROMBERG & RIBSTEIN, *supra* note 4, § 6.07(f).

¹²See *id.* § 6.06(c)(1); *Walter v. Holiday Inns, Inc.*, 985 F.2d 1232 (3d Cir. 1993).

¹³See DENNIS J. BLOCK ET AL., *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS* 199-209 (4th ed. 1993).

¹⁴See RESTATEMENT (SECOND) OF AGENCY § 381 (1958).

¹⁵UNIF. PARTNERSHIP ACT (last amended 1914), 6 U.L.A. 238 (1995) [hereinafter UPA].

partnership's business.¹⁶ With respect to matters outside of the scope of the firm's business, a partner is free to deal for his own benefit.¹⁷ But a partner is "not at liberty to deal on his own private account in any matter or business, which is obviously at variance with, or adverse to the business or interest of the partnership."¹⁸ Because fiduciary duties usually exist in circumstances where monitoring the fiduciary's behavior would be expensive or inconvenient,¹⁹ the duties are limited to the behavior to be monitored. Just as one partner's misuse of her home television (to view child pornography, for example) would not result in personal liability with regard to the other partners in a real estate venture, so another partner's theft of that television is not a breach of fiduciary duty.²⁰

Since the partner's fiduciary duty relates only to the firm's business, a breach of duty requires harm²¹ to the firm, both at common law²² and under

¹⁶See *Meinhard*, 164 N.E. at 548 (prohibiting usurpation of partnership opportunity only where there was "a nexus of relation between the business conducted . . . and the opportunity"). See also 1 SCOTT ROWLEY, *THE MODERN LAW OF PARTNERSHIP* § 389, at 459-60 (1916) ("In transactions concerning the interests of the firm [a partner] must consider their mutual welfare, rather than his own private benefit.") (quoting *Holmes v. Darling*, 100 N.E. 611, 612 (Mass. 1913)) (emphasis added); *id.* § 342, at 393-94 (stating that a partner is essentially a trustee for the partnership and its members). See generally Dalley, *supra* note 6, at 188-91 (noting that a partners' duties are limited to matters involving the business of the partnership). Cf. Allan W. Vestal, *Law Partner Expulsions*, 55 WASH. & LEE L. REV. 1083, 1087, 1117-20 (1999) (criticizing the cases limiting partnership duties to matters involving the partnership business).

¹⁷See *Latta v. Kilbourn*, 150 U.S. 524, 549 (1893).

¹⁸JOSEPH STORY, *COMMENTARIES ON THE LAW OF PARTNERSHIP* § 177 (1841).

¹⁹See Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 811-16 (1983); Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1212 (1995).

²⁰Cf. Joseph Biancalana, *Defining the Proper Corporate Constituency: Asking the Wrong Question*, 59 U. CIN. L. REV. 425, 432-40 (1990) (arguing that the decline of specific powers and purposes clauses in corporate charters left courts without a coherent way to apply legal standards to corporate decision making).

²¹This is not to say that the plaintiff partners must prove actual damages to the partnership in the situation where a partner deals adversely with the partnership. Generally, where a fiduciary receives a kickback or other "secret profit" the principal is entitled to have the fiduciary disgorge her profits, even if the principal cannot show actual damage. See *County of Cook v. Barrett*, 344 N.E.2d 540, 548 (Ill. App. Ct. 1975) (quoting *United States v. Carter*, 217 U.S. 286 (1910)). The rule is intended, in part, to avoid the problems of proof a principal would have showing actual harm, such as by loss of an opportunity to make a more advantageous bargain. The secret profit rule would also apply where the fiduciary is a partner and the principal is the partnership, as long as the business in which the secret profit was earned was the partnership's business.

²²See 1 ROWLEY, *supra* note 16, § 389 ("Good faith will not permit any one partner to advantage himself, singly and alone, at the expense of the firm."); STORY, *supra* note 18, § 177 (stating that a partner must not engage in any other business "which must necessarily deprive the partnership of a portion of the skill, industry, diligence, or capital, which he is bound to employ therein"); *id.* § 172, at 265 ("Good faith . . . requires . . . that [a partner] should abstain from all concealments, which may be injurious to the partnership business.").

the UPA.²³ Similarly, when a partner's actions do not harm the partnership as a whole (or as a group), there is no breach of duty, even if one or more of the partners is harmed individually.²⁴ By this reasoning, Donna's theft of Roger's television in Example 3, above, is not a breach of duty. The clearest application of this rule appears in the cases discussing expulsions from partnerships, where most courts have held that the partners' acts in expelling one partner cannot constitute a breach of fiduciary duty because only the expelled partner, and not the partnership, has been harmed.²⁵ In dealings between partners individually, the partners' rights are "as though they were not partners";²⁶ in other words, no fiduciary duty is owed.²⁷ Although the courts have almost unanimously refused to extend partners' duties beyond the partnership business, some commentators argue that the close personal relationship among partners, which is reflected in and enhanced by their unlimited liability for each other's acts, requires that fiduciary duties not be limited only to matters that directly affect the partnership business.²⁸

RUPA declared that partnerships are entities but has made no attempt to define the nature of the partnership entity. The text of and commentary on RUPA, however, suggests that the entity characterization of the partnership is not intended to alter the partners' fiduciary duties at all. The ABA Revision Subcommittee recommended revision of the UPA to clarify

²³FLOYD R. MECHEM, *ELEMENTS OF THE LAW OF PARTNERSHIP* § 170 (2d ed. 1920) ("one partner will not be permitted to make gain for himself at the expense of the firm"). See also Lawrence E. Mitchell, *The Naked Emperor: A Corporate Lawyer Looks at RUPA's Fiduciary Provisions*, 54 WASH. & LEE L. REV. 465, 474-75 (1997) ("[N]o strain of law of which I am aware prohibits a partner . . . from furthering his own interest unless he does so by dealing adversely or in competition with (and therefore to the detriment of) the partnership."). But see Claire Moore Dickerson, *Is it Appropriate to Appropriate Corporate Concepts: Fiduciary Duties and the Revised Uniform Partnership Act*, 64 U. COLO. L. REV. 111, 146 (1993) (arguing that the RUPA, which requires harm to the partnership, changed prior law).

²⁴See *Day v. Sidley & Austin*, 394 F. Supp. 986, 993-94 (D.D.C. 1975); *Holman v. Coie*, 522 P.2d 515, 523 (Wash. Ct. App. 1974).

²⁵See Dalley, *supra* note 6, at 191-92.

²⁶1 ROWLEY, *supra* note 16, § 399. See MECHEM, *supra* note 23, § 193; STORY, *supra* note 18, § 219. But see 1 ROWLEY, *supra* note 16, §§ 384, 389 (citing cases where partners were held liable for defrauding other partners individually). An exception to this rule sometimes existed where one partner was purchasing the interest of another. See generally *id.* § 400 (stating that a partners must disclose all material facts when seeking to purchase the interest of another partner).

²⁷See *Walter v. Holiday Inns, Inc.*, 985 F.2d 1232, 1247 (3d Cir. 1993) (holding that information prepared for one partner's use in buy-out negotiation did not have to be disclosed to other partner).

²⁸See J. William Callison & Allan W. Vestal, "They've Created a Lamb with Mandibles of Death": *Secrecy, Disclosure, and Fiduciary Duties in Limited Liability Firms*, 76 IND. L.J. 271, 304 n.144 (2001); Vestal, *supra* note 16, at 1117-20. Cf. RONALD DWORKIN, *LAW'S EMPIRE* 199 (1986) (arguing that in social groups, "responsibilities are *personal*[:] . . . they run directly from each member to each other member, not just to the group as a whole in some collective sense"). See *infra* note 219 and accompanying text (discussing this matter at greater length).

that "the partnership fiduciary duty has three dimensions: (i) a partner to the partnership, (ii) the partnership to the partners, and (iii) the partners inter sese."²⁹ Section 404 of RUPA states that a partner's duties are owed to "the partnership and the other partners."³⁰ As Dean Weidner notes, this formulation follows the old aggregate theory,³¹ since a true entity view would hold partners responsible only to the partnership.³² It would thus appear that RUPA's adoption of the entity theory neither alters nor advances the existing understanding of partnership fiduciary duties.³³

B. Corporations

The archetypal legal person is, of course, the corporation. One might think that the concept of the corporate entity would serve to illuminate fiduciary duties. Unfortunately, the nature of the corporate entity is itself both unclear and controversial. The question of corporate officers' and directors' fiduciary duties is particularly disputed. One would assume that, as a technical matter, duties would be owed to the corporation as an entity.³⁴

²⁹UPA Revision Subcommittee of the Committee on Partnerships and Unincorporated Business Organizations of the American Bar Association, *Should the Uniform Partnership Act be Revised?*, 43 BUS. LAW. 121, 151 (1987) [hereinafter ABA Subcommittee Report].

³⁰RUPA § 404.

³¹See Donald J. Weidner, *Three Policy Decisions Animate Revision of Uniform Partnership Act*, 46 BUS. LAW. 427, 433, 470 (1991).

³²Oddly, the drafters of the Uniform Limited Liability Company Act borrowed language from RUPA, stating that managers of LLCs owe duties to the "company or to the other members," despite the clear existence of the LLC as an entity and despite the availability of a member's derivative suit. See UNIFORM LIMITED LIABILITY COMPANY ACT §§ 201, 409, 1101, 6A U.L.A. 429, 443, 464, 504 (1995) [hereinafter ULLCA].

³³Thus, the entity view does not raise the need for a partner's derivative suit. If duties were owed only to the partnership as an entity, one might argue that only the entity should have standing to sue. See Jay Conison, *Suits for Benefits under ERISA*, 54 U. PITT. L. REV. 1, 10-11 (1992) (arguing that duties are owed only to the plan because under ERISA § 409(a) only the plan, not the beneficiaries, has a remedy for breach); Steven M.H. Wallman, *The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties*, 21 STETSON L. REV. 163, 165 (1991) (arguing that, since even under a statute recognizing nonshareholder interests, only the corporation has standing to sue, the duty is owed to the corporation).

³⁴See Deborah A. DeMott, *Down the Rabbit Hole and Into the Nineties: Issues of Accountability in the Wake of Eighties-Style Transactions in Control*, 61 GEO. WASH. L. REV. 1130, 1153-54 (1993) ("the conventional assumption is that directors' duties are owed to the corporation"); Samuel Williston, *The History of the Law of Business Corporations Before 1800*, in 3 SELECTED ESSAYS IN ANGLO-AMERICAN LEGAL HISTORY 195, 229 (Ass'n of Am. Law Schs. ed., 1909). It is surprisingly difficult to find a citation for this seemingly obvious principle. Some state corporation statutes provide that officers and directors must act in the "best interests of the corporation." See REVISED MODEL BUS. CORP. ACT §§ 8.30(a)(3), 8.42(a)(3) (1984); ALL PRINCIPLES OF CORPORATE GOVERNANCE § 4.01(a) (1994). Law and economics scholars reject this reification of the corporation. See Smith, *supra* note 3, at 214. Nevertheless, it appears to be the law.

A corporate agent's principal is the corporation,³⁵ and agents generally owe fiduciary duties to their principals.³⁶ It is a generally accepted legal principle that corporate officers and directors do not owe fiduciary duties directly to their shareholders.³⁷ This is evidenced by the fact that a shareholder seeking to hold a corporate manager liable for breach of fiduciary duty must act derivatively, that is, on behalf of the corporation, rather than directly, because the cause of action lies with the corporation, not with the shareholder.³⁸ In short, corporate fiduciaries owe their duties to the corporation as an entity.

The question of what constitutes the "corporation" for fiduciary duty purposes has been extensively debated over the past decade.³⁹ Simply stated, some commentators argue that the corporation consists only of the shareholders,⁴⁰ while others argue that fiduciary duties are owed (directly or

³⁵See 2 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 266, 437 (Victoria A. Braucher et al. eds., perm. ed. rev. vol. 1998). Technically, the directors are not agents. Their power derives from statute (e.g., DEL. GEN. CORP. L. § 141(a) (2001)) so it is "original." See *People ex rel. Manice v. Powell*, 94 N.E. 634, 637 (N.Y. 1911).

³⁶See RESTATEMENT (SECOND) OF AGENCY §§ 379, at 387-96.

³⁷See Paula J. Dalley, *From Horse Trading to Insider Trading: The Historical Antecedents of the Insider Trading Debate*, 39 WM. & MARY L. REV. 1289, 1298-302 (1998). The Supreme Court has premised liability for insider trading under the federal securities laws on a fiduciary duty owed by corporate insiders to shareholders. See *id.* at 1307-11. That duty, however, has not been recognized by modern courts in any other context. See, e.g., *Unocal v. Mesa Petroleum*, 493 A.2d 946, 954 (Del. 1985) (stating that board must consider "the best interests of the corporation and its shareholders" in the context of a hostile takeover); *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939) (stating that corporate officers and directors "stand in a fiduciary relation to the corporation and its stockholders" where injury alleged was misappropriation of a corporate opportunity).

³⁸See Wallman, *supra* note 34, at 165. See also ROBERT CHARLES CLARK, CORPORATE LAW § 15.9 (1986). There is an exception to this rule where the act about which the shareholders are suing relates to their rights *as shareholders*. Thus, a suit for breach of duty in declaring a dividend or obstructing a shareholder vote is brought directly, not derivatively. In such matters, the managers are fiduciaries for the shareholders directly because they are acting with respect to the shareholders' rights, not with respect to the corporation's interests. See *Blasius Indus. Inc. v. Atlas Corp.*, 564 A.2d 651, 660 (Del. Ch. 1988) (discussing difference between board actions relating to "the exercise of the corporation's power over its property" and those relating to "allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation").

³⁹See Smith, *supra* note 3, at 215-16 (providing a general discussion and bibliography); see also D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 280-83 (1998) (providing a general discussion and bibliography).

⁴⁰See Adolf A. Berle, *For Whom Corporate Managers are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932) ("[Y]ou can not abandon emphasis 'on the view that business corporations exist for the sole purpose of making profits for their stockholders . . ."). See also Ruthford B. Campbell, Jr., *A Positive Analysis of the Common Law of Corporate Fiduciary Duties*, 84 KENT L.J. 455, 470-71 (1996) (providing a positive analysis of the common law of corporate managers' fiduciary duties); A.A. Sommer, Jr., *Whom Should the Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later*, 16 DEL. J. CORP. L. 33, 35 (1991) (discussing the debate over the "other constituency statutes" and the interests corporations should properly serve).

indirectly) to a broader group that may include creditors, employees, customers, and larger societal interests.⁴¹ Other commentators argue that duties are owed to the corporation as an entity. They go on to argue that the entity has interests of its own that are separate from those of the shareholders or any other group.⁴² A corporation's interest is usually in "enhancing its ability to produce wealth indefinitely."⁴³ Thus, one might say corporate managers' fiduciary duties are owed to the business,⁴⁴ just as partners owe a duty to the partnership.

The law governing mergers and acquisitions recognizes that corporate managers owe fiduciary duties to the corporate entity as a business. Under Delaware law, when the break-up of a company is imminent, the directors have an obligation to seek the best deal possible for the shareholders and are not permitted to consider the interests of other parties, including creditors or employees (such as the incumbent management team).⁴⁵ In other situations, the directors are charged with protecting the enterprise as a whole, even when the board is considering a merger or other transaction that will

⁴¹See, e.g., Joseph William Singer, *Jobs and Justice: Rethinking the Stakeholder Debate*, 43 U. TORONTO L.J. 475 (1993); Cheryl L. Wade, *For Profit Corporations that Perform Public Functions: Politics, Profit, and Poverty*, 51 RUTGERS L. REV. 323 (1999). For a sample of the arguments on both sides, see Symposium, *Defining the Corporate Constituency*, 59 U. CIN. L. REV. 319 (1990); Symposium, *New Directions in Corporate Law*, 50 WASH. & LEE L. REV. 1373 (1993). The "other constituency" position is often attributed to E. Merrick Dodd, see Sommer, *supra* note 40, at 37, but his argument is somewhat different and is based on the idea of the corporate entity. See *infra* note 42. The "other constituency" position makes more sense when it is phrased as a duty to the corporation as an entity, whose interests benefit both shareholders and other groups, but few "stakeholder" commentators use this framework. The stakeholder model has also appeared in the popular business press. See Richard A. Booth, *It's Bosses, Not Shareholders, Who Own the Company*, WALL ST. J., Apr. 13, 1998, at A22; Marianne Jennings, *Trendy Causes are No Substitute for Ethics*, WALL ST. J., Dec. 1, 1997, at A22; Roger Lowenstein, *Microsoft and Its Two Constituencies*, WALL ST. J., Dec. 4, 1997, at C1.

⁴²See Wallman, *supra* note 34, at 163 *passim* (explaining that directors owe a duty solely to the corporation and not to any other group). See also HARRY G. HENN & JOHN R. ALEXANDER, *LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES* §§ 78, 144 (3d ed. 1983) ("The corporation, regardless of legal theories, has group interests distinguishable from the individual interests of its individual members."). See also Blair & Stout, *supra* note 5, at 280-81, 288-319 (arguing that the directors of public corporations are "trustees for the corporation itself").

⁴³See Wallman, *supra* note 34, at 170.

⁴⁴See *id.* at 170-71. Mr. Wallman also argues that defining the beneficiary of managers' duties as the corporation as a whole will encourage managers to focus on advancing the business and improving its competitiveness and profitability. *Id.* at 169-70.

⁴⁵See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986). The Revlon board argued that it was entitled to act to protect other constituencies, but the court said that "concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder." *Id.* (citations omitted).

fundamentally change the structure of the corporation.⁴⁶ For example, a board is permitted to consider conflicting interests, such as the interests of long-term and short-term shareholders without showing any preferences.⁴⁷ A board may also consider intangibles such as the corporation's culture.⁴⁸

These considerations also extend to defensive measures in the takeover context, that subject the board to a higher standard than the business judgment rule. The Delaware Supreme Court has allowed a board to act to protect the "strategic merits" of a merger with one party rather than another, where the board believed that it would better serve corporate objectives.⁴⁹ When considering any action, directors must engage in an analysis of the effect on the corporate enterprise. As the Delaware Supreme Court has stated, "Examples of such concerns may include: . . . the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally) [and] the basic stockholder interests at stake, including those of short term speculators."⁵⁰

⁴⁶*Cf. Atlas Corp.*, 564 A.2d at 659-60 (explaining that in recommending a merger or tender offer to the shareholders, the directors also owe a duty of care to the shareholders, because the action relates to their shares, and not to the corporation's business).

⁴⁷*See Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989) (citations omitted).

Delaware law imposes on a board of directors the duty to manage the business and affairs of the corporation. This broad mandate includes a conferred authority to set a corporate course of action, including time frame, designed to enhance corporate profitability. Thus, the question of "long-term" versus "short-term" values is largely irrelevant because directors, generally, are obliged to charter a course for a corporation which is in its best interest without regard to a fixed investment horizon.

Id. at 1150. *See also id.* at 1153 ("[P]recepts underlying the business judgment rule militate against a court's engaging in the process of attempting to appraise and evaluate the relative merits of a long-term versus a short-term investment goal for shareholders.").

⁴⁸*See id.* at 1144, 1152 (explaining that the "culture" involved was Time's reputation for "journalistic integrity"); *see also* ALI PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 34, § 4.01 (providing that the "objective" of the corporation is the "conduct of business activities with a view to enhancing corporate profit and shareholder gain" but that the corporation may also take into account ethical considerations and may devote resources to "public welfare, humanitarian, educational and philanthropic purposes").

⁴⁹*See Paramount Communications*, 571 A.2d at 1148, 1153 (discussing Paramount's argument that the Time board, by preferring a merger with Warner Communication, Inc. and seeking to prevent a merger with Paramount, was not acting in response to a legitimate "threat to corporate policy and effectiveness," as required by *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985)). The court in *Paramount Communications* ruled that the Time board could consider as a legitimate threat the fear that Time's shareholders might not fully understand the strategic merits of a combination with Warner. *Paramount Communications*, 571 A.2d at 1148, 1153. Further, the court ruled that the Time board was sufficiently informed about the Paramount offer because the board had earlier considered and rejected Paramount as a merger partner because "Paramount did not serve Time's objectives or meet Time's needs." *Id.* at 1154.

⁵⁰*Unocal Corp.*, 493 A.2d at 955-56.

This concern is simply a reflection of the fact that corporate managers owe duties to the corporate enterprise as a whole.⁵¹ What may be good for some shareholders, such as a premium for their shares offered by a hostile bidder, may not be good for the corporation. Not only is the "shareholder primacy norm"⁵² illusory, since different shareholders will have different interests, it is also contrary to the concept of the corporation both legally, as an entity, and practically, as a business.⁵³

C. *Limited Liability Companies*

Since LLCs are relatively new forms of business organizations, there is limited interpretive case law available and the parameters of the fiduciary duties owed by managers are as yet undetermined. The Uniform Limited Liability Company Act,⁵⁴ similar to RUPA, provides that fiduciary duties are owed to the LLC and its members. In a member-managed LLC, all members owe fiduciary duties, while in a manager-managed LLC, only those members serving as managers owe duties.⁵⁵ Members who are not managers are permitted to bring a derivative suit on behalf of the LLC for a breach of the fiduciary duty.⁵⁶ This suggests that the managers owe a duty directly to the LLC.⁵⁷

D. *Trusts and Benefit Plans*

The fiduciary duties of partners and corporate managers that are owed to the business rather than to the individuals composing the business can be compared to duties owed to other quasi-entities. These entities include trusts and employee benefit plans under the Employee Retirement Income Security

⁵¹See Singer, *supra* note 41, at 476-78.

⁵²See Smith, *supra* note 39, at 278 n.1 (discussing the "shareholder primary norm").

⁵³See ALI PRINCIPLES OF CORP. GOVERNANCE, § 5.05(b) (1994) (explaining that the duties of corporate fiduciaries, like those of partners, are limited to matters related to the conduct of the corporation's business, thus, prohibiting a corporate officer or director from taking an opportunity that comes to her in her capacity as a corporate insider and relates to the company's business).

⁵⁴UNIFORM LIMITED LIABILITY COMPANY ACT § 409, 6A U.L.A. 464 (1995).

⁵⁵See *id.*

⁵⁶See *id.* §§ 1101-1104; see also DEL. CODE ANN. tit. 6, § 18-1001 (1999) ("A member of an assignee of a limited liability company interest may bring an action in the Court of Chancery . . . to recover a judgment . . ."; Taurus Advisory Group, Inc. v. Sector Mgmt., Inc., No. CV96 0150830, 1996 Conn. Super. LEXIS 2272, at *9 (Conn. Super. Aug. 29, 1996) (holding that DEL. CODE ANN. tit. 6, § 18-1001 (1999), permits a member of an LLC to file a derivative action).

⁵⁷See Charles W. Murdock, *Limited Liability Companies in the Decade of the 1990s: Legislative and Case Law Developments and Their Implications for the Future*, 56 BUS. LAW. 499, 527 (2001) (arguing that the duties of care and loyalty must be owed to the entity, not to the other members, in an LLC).

Act of 1974⁵⁸ (ERISA). Trust law provides that a trustee owes fiduciary duties to the beneficiaries of the trust.⁵⁹ When there are several beneficiaries, the trustee must deal impartially among them,⁶⁰ and when they have conflicting interests, "the trustee is under a duty so to administer the trust as to preserve a fair balance between them."⁶¹ The duty of a trustee to the beneficiaries, however, is limited to the administration of the trust. When the trust involves carrying on a business, the trustee is under a duty not to compete with the *trust's* business, but may compete with the individual businesses of the beneficiaries.⁶² Thus, "the position of the trustees of an estate is to . . . do the best for the estate, looking upon it as a whole. . . . They must act prudently and properly in the management of the estate as a whole."⁶³

This is similar to the requirements of plan fiduciaries under ERISA. ERISA requires that plan fiduciaries administer plans "solely in the interest of the participants and beneficiaries."⁶⁴ With respect to individual beneficiaries, "the trustees must deal evenhandedly among them, doing [their] best for the entire trust looked at as a whole."⁶⁵ In other words, duties are owed to the conceptual trust, not to the individuals it comprises. "A[n] [ERISA] fiduciary is not required, or even permitted, . . . to carry out his duties in the separate interests (plural) of the participants and beneficiaries. To the contrary, he is required to carry out his duties in their 'interest' (singular)."⁶⁶ Thus, the fiduciary's duty under ERISA is to an "activity" — the payment of benefits — rather than to an individual or group of individuals.⁶⁷

⁵⁸29 U.S.C. § 1001 (1994).

⁵⁹See 2A AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, *THE LAW OF TRUSTS* § 170 (4th ed. 1987).

⁶⁰See *id.* § 183.

⁶¹3A AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, *THE LAW OF TRUSTS* § 232 (4th ed. 1987).

⁶²See 2A SCOTT & FRATCHER, *supra* note 59, § 170.23. See also *In re Hanes*, 214 B.R. 786, 823-24 (E.D. Va. 1997) (holding that there is no privity between the attorney for the trust and the beneficiaries of the trust).

⁶³See 2A SCOTT & FRATCHER, *supra* note 59, § 183 (quoting *In re Charteris*, 2 Ch. 379, 388 (1917)).

⁶⁴*Morse v. Stanley*, 732 F.2d 1139 (2d Cir. 1984). See also 29 U.S.C. § 1104(a)(1)(A)(i) (1994) (stating that a fiduciary shall discharge his duties solely in the interest of the beneficiaries).

⁶⁵*Morse*, 732 F.2d at 1145; RESTATEMENT (SECOND) OF TRUSTS § 183 (1957) (stating that when there are two or more beneficiaries, a trustee is under a duty to deal impartially).

⁶⁶*Cf.* Jay Conison, *The Federal Common Law of ERISA Plan Attorneys*, 41 SYRACUSE L. REV. 1049, 1075 (1990) (noting that plan fiduciaries owe their duties "with respect to," rather than "to" the plan).

⁶⁷See *id.* at 1076.

Although the rules for fiduciaries of partnerships, corporations, trusts, and employee benefit plans have all developed more or less separately, they all concern distinct groups of individuals operating a business regardless of whether they are legally treated as an aggregate, an entity, or a mere common pool of property. A breach of the fiduciary duties of the managers of the business must therefore involve an act not in the interests of the distinct group. Before we can determine how to define the interests of the group, we must first understand the nature of the group involved.

III. THE NATURE OF BUSINESS ASSOCIATIONS

There has been considerable academic debate over the past century about the legal nature of partnerships and corporations. Despite this considerable debate, the theories propounded and the principles deduced therefrom have had little effect on the law of fiduciary duties. Nevertheless, since fiduciary duties are said to be owed "to the partnership"⁶⁸ and to the corporation,⁶⁹ it is essential to understand the identity and nature of those bodies.

How does a fiduciary, owing a duty to an "entity" or "to the partners and the partnership," make a decision? Is Donna's theft of Roger's television a breach of her fiduciary duty? Why is it true that when Xavier decides to pursue an opportunity that puts him into competition with the business of a shareholder, he has not breached his fiduciary duty? There is a long line of literature from the late nineteenth and early twentieth centuries seeking to provide some answers to these questions and to explain corporate personality,⁷⁰ partnership law,⁷¹ and the nature of groups generally.⁷² The

⁶⁸See, e.g., THEOPHILUS PARSONS, A TREATISE ON THE LAW OF PARTNERSHIP 231 (1893). See also ROWLEY, *supra* note 16, §§ 116, 342 (explaining that the partnership relationship is one of trust); ABA Subcommittee Report, *supra* note 29, at 151 (stating that the partnership fiduciary duty comprises duties of partner to partnership, partnership to partners, and partners *inter sese*).

⁶⁹See DeMott, *supra* note 34, at 1153-54.

⁷⁰See, e.g., FREDERICK HALLIS, CORPORATE PERSONALITY (Scienta Verlaag Aalen 1978) (1930); see also Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865 (1990) (discussing the controversy and debate concerning corporate identity in the context of a takeover); Larry E. Ribstein, *The Constitutional Conception of the Corporation*, 4 SUP. CT. ECON. REV. 95 (1995) (discussing the "corporate person," "contractual," and "unconstitutional conditions" views of the corporation).

⁷¹See PARSONS, *supra* note 68, at 170-71 (explaining that partnership law has not been subject to the intense theoretical debate that has characterized corporate law). The drafters of both the UPA and RUPA based their theories of the nature of the partnership on the perceived practical needs of partnership law rather than on theoretical analysis. Compare Gary S. Rosin, *The Aggregate-Entity Dispute: Conceptualism and Functionalism in Partnership Law*, 42 ARK. L. REV. 395, 415-17 (1989), and ABA Subcommittee Report, *supra* note 29, at 124, 184 with Weidner, *supra* note 31, at 433.

literature, however, has proven of little help in clarifying fiduciary duties.

A. *The Legal Nature of the Partnership*

The nature of the corporation has been hotly contested for over a century in corporate law circles.⁷³ In contrast, the nature of the partnership has been largely ignored by observers of partnership law. After several decades of debate in the nineteenth century, scholars accepted that the corporation was a legal entity,⁷⁴ but the nature of the partnership was left indeterminate until adoption of the RUPA in 1994.

At common law, a partnership was a relationship.⁷⁵ Justice Story called it "a voluntary contract,"⁷⁶ and Theophilus Parsons defined it as "the association of two or more persons . . . for the purpose of carrying on business together and dividing the profits between them."⁷⁷ After adoption of the UPA in 1916, commentators, such as Floyd Mechem, continued to describe the partnership in such terms by referring to the partnership as a contractual relationship.⁷⁸ The UPA's "aggregate" definition of a partnership, "an *association* of two or more persons to carry on as co-owners a business for profit,"⁷⁹ can be interpreted as a mere re-phrasing of the common law concept of the partnership as a relationship.⁸⁰ The partnership agreement, whether implicit or explicit, creates the relationship, just as any

⁷³See MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1870-1960*, at 90-98 (1992) (describing legal realists' attack on "conceptualism" in corporate law); Eric W. Orts, *The Complexity and Legitimacy of Corporate Law*, 50 WASH. & LEE L. REV. 1565, 1567-87 (1993) (arguing that attempts to understand corporate law that begin with theoretical questions are misguided); Rosin, *supra* note 71, at 400-01 (rejecting use of theory in partnership law).

⁷⁴See generally Smith, *supra* note 39 (explaining the "shareholder primary norm" theory); cf. Adolf A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931) (arguing that the powers granted to a corporation are only exercisable for the benefit of all shareholders).

⁷⁵See *infra* Part III.B.

⁷⁶See ROSCOE POUND, *THE SPIRIT OF THE COMMON LAW* 14, 21-31 (1931) (discussing the prevalence of the concept of relationships in Anglo-American law, including partnership law); see also Zechariah Chafee, Jr., *The Internal Affairs of Associations Not for Profit*, 43 HARV. L. REV. 993 (1930) (arguing for a relationship-based conception of clubs).

⁷⁷STORY, *supra* note 18, § 2. The full definition is "a voluntary contract between two or more persons [to place their assets into business] with the understanding that there shall be a communion of the profits thereof between them." *Id.*

⁷⁸PARSONS, *supra* note 68, § 1. The partnership is identified by the business in which it engages. The early treatise writers make clear that a partnership is a relationship formed to carry on a business. See *id.*

⁷⁹MECHEM, *supra* note 23, § 4.

⁸⁰UPA § 6(1) (emphasis added).

⁸¹See Rosin, *supra* note 71, at 403.

contract creates a relationship.⁸¹

1. The Aggregate as a Distinct Group

To define a partnership as a relationship is not particularly helpful, however. According to common law commentators, a partnership has a personality that consists of a *group* of persons separate from those persons in their individual capacities. In his commentary, Dean Lewis remarked, "[P]artnership means something more than 'all the partners.' It means all the partners *as associated* to carry on a particular business."⁸² Various legal doctrines implicitly recognize that the group takes on a different character by virtue of being a partnership.⁸³

The common law aggregate understanding of the partnership as a group with a distinct identity (the "distinct group" theory) also comports with the layperson's view of a partnership. Persons actually conducting business as a partnership tend to view their partnership business as separate from their other activities, perhaps even as an "entity" in some nonlegal sense.⁸⁴ The

⁸¹I do not intend this to be a controversial assertion, although some have argued that not all contracts create relationships. See Melvin A. Eisenberg, *Relational Contracts*, in GOOD FAITH AND FAULT IN CONTRACT LAW 291, 296 (Jack Beatson & Daniel Friedmann eds., 1995) (arguing that most contracts involve relationships but that some involve only a "bargain"). Cf. RUDOLF VON IHERING, *LAW AS A MEANS TO AN END* 95 (Isaak Husik trans., 1913) (distinguishing between bargain contracts and partnership contracts on the basis of whether the relationship is based on different goals or a common goal). "In exchange the purpose of the one differs from that of the other, and herein lies the reason of their *changing*; in partnership the purpose, the aim, is the same, and that is why they *unite*." See *id.*

⁸²William Draper Lewis, *The Uniform Partnership Act—A Reply to Mr. Crane's Criticism*, 29 HARV. L. REV. 158, 295 (1915-16) (emphasis added); see also MECHEM, *supra* note 23, § 1 ("The partners collectively are often called the *firm*.").

⁸³See HENN & ALEXANDER, *supra* note 42, § 78, for a similar argument with respect to corporations. See also Frederic William Maitland, *Moral Personality and Legal Personality*, in 3 COLLECTED PAPERS 307-07 (H.A.L. Fisher ed., 1911) (noting that the modern association is usually formed for a single purpose; thus, one may be a member of many groups). See OTTO VON GIERKE, *COMMUNITY IN HISTORICAL PERSPECTIVE: A TRANSLATION OF SELECTIONS FROM DAS DEUTSCHE GENOSSENSCHAFTSRECHT (THE GERMAN LAW OF FELLOWSHIP)* 23 (Mary Fischer trans., Antony Black ed., 1990) (stating that the modern association "rests on the possibility of belonging with one part, one aspect of one's individuality, perhaps with only one closely defined part of one's range of ability, to one organisation, and with others to others"). See also *id.* at 120 (describing phenomenon of single-purpose groups).

⁸⁴See PARSONS, *supra* note 68, § 1; 1 ROWLEY, *supra* note 16, at 117 ("For all practical business dealings, the merchant regards a partnership or firm as an entity . . .") See also Maitland, *supra* note 83, at 307-08 (describing the layperson's understanding of an entity); Harold J. Laski, *The Personality of Associations*, 29 HARV. L. REV. 404, 407-08, 417-24 (1915-16) (describing the layperson's understanding of associations that are not entities, such as the stock exchange or a club); Frederic William Maitland, *Translator's Introduction to OTTO GIERKE, POLITICAL THEORIES OF THE MIDDLE AGE* xxii, xli (Frederic William Maitland trans., 1900). Cf. Weidner, *supra* note 31, at 430 (justifying RUPA's adoption of entity view with observation that people think of partnerships as

partnership has its own books, and the accounts of the partnership will generally be kept separate from those of the partners, even in the most informal partnership. As Dean Lewis argued, the UPA's aggregate conception of the partnership was consistent with this layperson's view of the partnership.⁸⁵

The distinct group concept of the partnership that prevailed at common law and under the UPA was not mere theory. It considered and was shaped by business and legal practice and the common law rules applicable to partnerships. For example, partners are permitted to enter into transactions with the partnership, as long as the terms are fair to the partnership.⁸⁶ Such contracts make sense only if the partners are understood to have individual identities and interests separate from those of the group.⁸⁷ This concept applies to partnership property as well.

Early commentators treated partnership property as owned conceptually by the partnership rather than by the individuals. For example, Joseph Story wrote that "all the partnership property and partnership contracts should be managed for the equal benefit of all the partners, according to their respective interests and shares therein."⁸⁸ The American Bar Association also adopted this concept of the partnership. The ABA's Standing Committee on Ethics and Professional Responsibility, citing numerous judicial opinions, stated that a partnership attorney represents "the entity rather than the individual partners," despite the fact that, at the time, a partnership was not considered a legal entity.⁸⁹ "[T]he rationale behind [the rule] is that an organization will have goals and objectives that may, or may not, be consistent with the goals and objectives of all or some of its members"⁹⁰

having an identity separate from the identity of the partners).

⁸⁵See Lewis, *supra* note 82, at 160-62 (noting that the UPA's aggregate theory is not to be confused with the theory that a partnership is a legal entity, much like sole proprietors who often keep separate personal and business accounts but never view their business selves as separate legal entities).

⁸⁶MECHEM, *supra* note 23, § 194.

⁸⁷See ERNST FREUND, *THE LEGAL NATURE OF CORPORATIONS* § 4 (1897), for a similar point about corporations.

⁸⁸STORY, *supra* note 18, § 174.

⁸⁹ABA Comm. on Ethics and Prof. Responsibility, Formal Op. 91-361 (1991).

⁹⁰*Id.* (explaining that while one might think this approach adopts an entity view, it is perfectly consistent with the traditional view of the partnership as a distinct group). In fact, much of the pressure to move to an entity theory of partnership may in fact stem from a misunderstanding of the nature of the "aggregate" originally contemplated under the UPA. *Id.* A disquisition on the aggregate/entity debate is, however, beyond the scope of this article. *Id.*

2. The Entity Theory

Since the drafting of the UPA, commentators have advocated treating partnerships as legal persons or "entities."⁹¹ This also is the approach adopted by the drafters of RUPA.⁹² RUPA's unequivocal statement that "[a] partnership is an entity distinct from its partners"⁹³ ended over a century of ambivalence and confusion in American law about the nature of the partnership. This, however, has gone largely unnoticed. Since RUPA's adoption, there has been a flurry of academic interest in partnerships,⁹⁴ but little of the renewed debate has focused on the "entity question."⁹⁵ Most scholars were apparently relieved that the entity question had finally been settled and considered the aggregate/entity debate⁹⁶ boring, and archaic.⁹⁷ One might anticipate the characterization of the partnership as an entity to

⁹¹See, e.g., Judson A. Crane, *The Uniform Partnership Act — A Criticism*, 28 HARV. L. REV. 762 (1914-15) [hereinafter Crane, *Criticism*]; Judson A. Crane, *The Uniform Partnership Act and Legal Persons*, 29 HARV. L. REV. 838 (1915-16) [hereinafter Crane, *Legal Persons*].

⁹²See RUPA, § 201.

⁹³*Id.* But see Weidner, *supra* note 31, at 433 (stating that RUPA does not mandate an entity approach, and that small partnerships may choose to follow an aggregate model instead).

⁹⁴There have been at least two law review symposium issues on RUPA-related topics: *See Partnerships*, 58 LAW & CONTEMP. PROBS. 1 (1995); and *Symposium on the Future of the Unincorporated Firm*, 54 WASH. & LEE L. REV. 389 (1997). *See also* Dickerson, *supra* note 23 (arguing that RUPA section 404 changed prior law, and thus "courts will have to determine whether a fiduciary's act that clearly benefits the fiduciary also harms the beneficiary); Robert M. Phillips, *Good Faith and Fair Dealing under the RUPA*, 64 U. COLO. L. REV. 1179 (1993) (discussing many of the changes in RUPA from the existing UPA); Larry E. Ribstein, *The Revised Uniform Partnership Act: Not Ready for Prime Time*, 49 BUS. LAW. 45 (1993) (discussing several problems RUPA may cause for informal firms); Allan W. Vestal, *Fundamental Contractarian Error in the Revised Uniform Partnership Act of 1992*, 73 B.U. L. REV. 523 (1993) (discussing RUPA's shift to a contractarian view rather than a fiduciary view of partnership and the negative effect it may have on partnership law); *Symposium on Withdrawals and Expulsions from Law Firms: The Rights and Duties of Partners and their Firms*, 55 WASH. & LEE L. REV. 997 (1999) (discussing RUPA's departure from the UPA in attempting to create affirmative disclosure obligations under section 403).

⁹⁵The few articles addressing the entity question have focused on specific provisions of RUPA, rather than on the theoretical merits of the entity characterization generally. *See* Robert W. Hillman, *RUPA and Former Partners: Cutting the Gordian Knot With Continuing Partnership Entities*, 58 LAW & CONTEMP. PROBS. 7 (1995) (discussing continuing partners' liabilities); Deborah A. DeMott, *Our Partners' Keepers? Agency Dimensions of Partnership Relationships*, 58 LAW & CONTEMP. PROBS. 109 (1995) (comparing RUPA partnerships to agency relations).

⁹⁶See Crane, *Criticism*, *supra* note 91, at 763; Crane, *Legal Persons*, *supra* note 91, at 838; A. Ladru Jensen, *Is A Partnership Under the UPA an Aggregate or an Entity?*, 16 VAND. L. REV. 377 (1963).

⁹⁷As the Reporters for RUPA describe it, the drafting process ignored the aggregate/entity question entirely. When the Drafting Committee realized that the provisions they had drafted according to their "pragmatic" approach in fact reflected an entity view, they added a section stating that partnerships are entities. *See* Donald J. Weidner & John W. Larson, *The Revised Uniform Partnership Act: The Reporters' Overview*, 49 BUS. LAW. 1, 3 (1993).

affect fiduciary duties, or at least draw attention to the issue, but neither the drafters nor the commentators of RUPA appear to have considered the effect of the entity characterization on fiduciary duties at all.⁹⁸

As a legal person, a partnership can hold property, sue, and be sued in its own name.⁹⁹ Because the law recognizes the partnership as a separate being, a change in the identity of the partners no longer necessarily results in the dissolution of the partnership.¹⁰⁰ Additionally, large partnerships, such as some law and accounting firms, are managed (similar to the management of corporations) by a small group of managers rather than by all of the partners as a group. Such partnerships often function as corporations, under their own names, which often have no relation to the identity of the current partners.¹⁰¹ The entity theory, it can be argued, brings the law into accordance with this reality. But the entity characterization is purely a legal one, because a distinct group may be just as separate in the minds of its members as is a legal entity. The only difference is whether the law recognizes that separate thing.¹⁰² Thus, in a sense, RUPA's entity characterization simply gives legal recognition to the distinct group concept that had been present all along, but hidden in the old common law sense of the "aggregate." Defining a partnership as an entity, therefore, does not solve the fiduciary duty problem.¹⁰³

⁹⁸See Weidner, *supra* note 31, at 434-35, for a discussion of the entity theory in the context of fiduciary duties. Dean Weidner has suggested that RUPA's narrowing of the fiduciary duties owed by partners is connected to the entity theory, in that it is to be expected that each partner will have less moral responsibility for the partnership's acts if the partnership is a separate entity. See also Weidner, *supra* note 31, at 433 (stating that, under RUPA, a partner's fiduciary duties are owed both to the partnership and to the other partners, which illustrates his proposition that the aggregate approach has not been completely annihilated by RUPA). See RUPA § 404(b).

⁹⁹See generally ABA Subcommittee Report, *supra* note 29 (discussing the advantages of the entity theory). Additionally, at common law there was some doubt about whether a partner could "embezzle" from a partnership. See *id.* at 154 (citing Annotation, *Embezzlement, Larceny, False Pretenses, or Allied Criminal Fraud by a Partner*, 82 A.L.R.3d 822 (1978)).

¹⁰⁰See RUPA § 801 & cmt.

¹⁰¹The availability of other forms of business association, such as limited liability companies, has reduced the number of firms for which this is the case, and so may have reduced some of the force of the arguments in favor of the entity theory.

¹⁰²See von Gierke, *supra* note 7, at 139.

¹⁰³Both the RUPA and the Uniform Limited Liability Company Act (the ULLCA) state that duties are owed to the partnership or company *and* to the other partners or members, see RUPA § 404; UNIFORM LIMITED LIABILITY COMPANY ACT § 409, 6A U.L.A. 443 (1995), despite the fact that partnerships under RUPA and limited liability companies under the ULLCA are expressly "entities." See RUPA § 201; ULLCA § 201.

3. Corporate Personality¹⁰⁴

Initially, corporations were considered to be "artificial entities" created by the legislature through the act of incorporation.¹⁰⁵ The artificial entity did not have personal characteristics (such as citizenship, residence, and *mens rea*) of its own,¹⁰⁶ and the artificiality of the entity subjected it to the will of the legislature.¹⁰⁷ Corporate law theorists for a time also advocated an "aggregate theory" of corporations which resembled a simplified understanding of partnership law that treated the corporation as a mere group operating under a common name, or, as one commentator phrased it, as a set of parentheses in an algebraic formula.¹⁰⁸ Under this "mere group" theory, the nature of the individuals constituting the group is no different when they are in their group than when they are out of it.¹⁰⁹ Under this theory, the corporation was best seen as a relationship similar to a partnership and not as an entity at all.¹¹⁰ The mere group theory of the corporation fell from favor and the "natural entity" theory, holding that a corporation was a real person separate from the state and from the individuals the corporation was composed of, essentially won the field.¹¹¹

The natural entity theory recognized a corporation as a real, rather than a fictitious, being based on the actual nature of the group.¹¹² If the corporation was a legal person in its own right and not dependent upon a status granted by the legislature, where did it get its personality? A legal

¹⁰⁴The following discussion is a brief summary only. For a detailed historical study of the corporate personality debates, see HORWITZ, *supra* note 72, at 65-107.

¹⁰⁵The artificial entity theory disappeared around the beginning of the twentieth century. *See id.* at 72-73. *But see* Larry D. Soderquist, *Theory of the Firm: What a Corporation Is*, 376 J. CORP. L. 375, 375-76 (2000) (describing the artificial entity theory as the "current legal conception of the corporation").

¹⁰⁶In some cases courts attributed those characteristics to the corporation based on the characteristics of the individuals who comprised the entity (i.e., the shareholders). *See* HALLIS, *supra* note 70, at xli-lij; E. MERRICK DODD, *AMERICAN BUSINESS CORPORATIONS UNTIL 1860*, at 35, 37, 65-66 (1954).

¹⁰⁷*See* HALLIS, *supra* note 70, at 10-11, 25-27; HORWITZ, *supra* note 72, at 76-77.

¹⁰⁸*See* HALLIS, *supra* note 70, at 173. *See also* Maitland, *supra* note 83, at xxv-xxvi (describing a corporation as a "group-person").

¹⁰⁹*See* HALLIS, *supra* note 70, at 173-74.

¹¹⁰*See id.* at 151 (discussing Otto von Gierke's distinction between the civil law *universitas* (roughly, a municipal corporation) and *societas* (partnership)). *See also* von Gierke, *supra* note 7, at 145, 149 (explaining that a community is a collection of individuals who "are controlled by physical and intellectual influences which flow from their membership in the institution").

¹¹¹*See* E. Merrick Dodd, *For Whom are Corporate Managers Trustees*, 45 HARV. L. REV. 1145, 1159-60 (1932). For a general discussion, see FREUND, *supra* note 87, §§ 4-6.

¹¹²*See* Adolf A. Berle, Jr., *The Theory of Enterprise Entity*, 47 COLUM. L. REV. 343, 344, 354 (1947); FREUND, *supra* note 87, § 45. Berle writes, "[B]elow the corporation papers there is always an enterprise." Berle, *supra*, at 354.

person was generally defined as the "subject of legal rights and duties."¹¹³ Why was a corporation such a subject? For that matter, why were human beings? One theory based personality on the existence of a "will."¹¹⁴ This created a problem for corporations, which do not have a will in the sense that an individual does.¹¹⁵ One solution to this problem is to argue that a corporation has a "will" because the board of directors is empowered to speak for the corporation.¹¹⁶ Another solution is to define personality based on purpose or interest rather than on will,¹¹⁷ or on some combination of purpose and will.¹¹⁸ The corporate "purpose" is the purpose for which the individual members have joined,¹¹⁹ or in other words, the interest they have in common, rather than their respective individual interests, which will vary among them.¹²⁰ A theory that combines purpose and will enables the "organ" of the entity, which expresses the entity's will, to define, amend and execute their purpose.¹²¹ One early corporate law commentator also proposed a "representation" theory based on the recognition of the unified purpose of the corporate group.¹²²

¹¹³See JOHN CHIPMAN GRAY, *THE NATURE AND SOURCES OF THE LAW* 27 (2d ed. 1921). See also FREUND, *supra* note 87, § 7 (discussing rights and duties).

¹¹⁴See GRAY, *supra* note 113, at 27. See also Crane, *Legal Persons*, *supra* note 91, at 838-39 (apparently adopting will theory for partnerships). But see Bryant Smith, *Legal Personality*, 37 *YALE L.J.* 283, 291-92 (1928) (rejecting will theory of personality). Cf. Cecil Thomas Carr, *Early Forms of Corporateness*, in 3 *SELECT ESSAYS IN ANGLO-AMERICAN LEGAL HISTORY* 161, 172 (Assoc. of Am. Law Schools ed., 1909) ("To regard the group as a single person would be impossible until the group was regarded as a single will."); see also Maitland, *supra* note 83, at xxv-xxvi (describing the German theory of the corporation as a real person with a will); *id.* at xi-xii (criticizing the English view that the corporation has no will).

¹¹⁵See HALLIS, *supra* note 70, at 86 (describing Duguit's theory of personality, which argued that, since the only true will is the individual will, at most the corporation could be a collection of individual wills).

¹¹⁶See FREUND, *supra* note 87, § 42 (discussing and rejecting idea of corporate will); GRAY, *supra* note 113, at 51-52; HALLIS, *supra* note 70, at 156 (discussing von Gierke's theory of personality); *id.* at 103 (discussing Duguit's theory of personality).

¹¹⁷See HALLIS, *supra* note 70, at 169-72 (discussing von Jhering's theory of personality); Berle, *supra* note 112, at 355 (arguing that the "enterprise entity" is based on the interests of the shareholders); Carr, *supra* note 114, at 169-70 (noting that a common purpose made medieval boroughs, unlike villages, "corporate"); Dodd, *supra* note 111, at 1146-1149 (discussing corporate purpose); Maitland, *supra* note 83, at xxvii (same). See also VON GIERKE, *supra* note 83, at 243 (arguing that a "group-person" exists by virtue of having a purpose).

¹¹⁸See HALLIS, *supra* note 70, at 185, 191, 214, 216, 225, 241-42. See also FREUND, *supra* note 87, §§ 31-32 (defining corporate identity through principle of representation of group interests).

¹¹⁹See HALLIS, *supra* note 70, at 35.

¹²⁰See *id.* at 130, 147.

¹²¹See *id.* at 101-04, 241-42. See also FREUND *supra* note 87, §§ 42-43 (describing representation theory and arguing that the corporation does not have a "metaphysical unity" but a unity "derived from the operation of undivided control in the association").

¹²²See FREUND, *supra* note 87, § 45.

In recent years, a new¹²³ theory of the corporation has arisen: the corporation is a "nexus of contracts" and not an entity at all.¹²⁴ The nexus-of-contracts theory eliminates the concept of the nature of the corporation and redefines the issue as essentially a question of contract. The various legal regimes governing corporations are treated as contractual: the corporate charter is a contract between investors and managers, and statutes are standard-form contracts. Although the nexus-of-contracts theory has been popular with theorists, applications of the law continue to view corporations as natural entities with some form of a separate will.¹²⁵

Unlike the debate over the nature of the partnership, the commentary relating to corporate personality has drawn somewhat from the theoretical literature about groups. Nevertheless, the utility of that literature has been largely ignored in recent years as debates about fiduciary duties have focused on the "constituencies" of the corporate entity,¹²⁶ just as the literature has been ignored in the debate over partnership fiduciary duties. A review of the theoretical literature reveals, however, that its conclusions are strikingly

¹²³In some ways, this theory recalls that of the "mere group" theorists of the late nineteenth century, who analyzed the corporation as a contract. See VON GIERKE, *supra* note 83, at 198-99 (arguing that the corporation is not based on contract); Maitland, *supra* note 84, at xxiv-xxv (discussing same); von Gierke, *supra* note 7, at 155 (same). See generally William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1513-17 (1989) (putting the nexus-of-contracts theory in historical perspective).

¹²⁴See Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); Smith, *supra* note 3, at 216. For a response to the nexus of contracts theory, see Jeffrey Pfeffer, *Understanding Organizations: Concepts and Controversies*, in II DANIEL T. GILBERT ET AL., THE HANDBOOK OF SOCIAL PSYCHOLOGY 733, 743-44 (1998). See also Ross B. Grantham, *Commentary on Goddard, in CORPORATE PERSONALITY IN THE 20TH CENTURY* 65, 68-69 (Charles E.F. Rickett & Ross B. Grantham eds., 1998) ("Despite our penchant for reification, the company is merely a set of rules which provides for the application of general principles of law . . . in a manner different from that when applied to individuals.") (citations omitted); Soderquist, *supra* note 105, at 376-81 (describing "constellation" theory of the corporation).

¹²⁵See *Cedric Kushner Promotions, Ltd. v. King*, 121 S. Ct. 2087, 2091 (2001).

[T]he employee and the corporation are different persons, even where the employee is the corporation's sole owner. After all, incorporation's basic purpose is to create a distinct legal entity, with legal rights, obligations, powers, and privileges different from those of the natural individuals who created it, who own it, or whom it employs.

See also KIP SCHLEGEL, *JUST DESERTS FOR CORPORATE CRIMINALS* 81, 121 (1990) (arguing that a corporation can be deemed to have *mens rea* when its policies, procedures, or structure indicate that the act was intended by the corporation); *supra* notes 48-52 and accompanying text.

¹²⁶In a welcome change, two recent articles do address exactly this issue. See generally Smith, *supra* note 3 (approaching the "corporate personality" issue from an economic perspective); Katsuhito Iwai, *Persons, Things and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance*, 47 AM. J. COMP. L. 583 (1999) (approaching the "corporate personality" issue from a comparative perspective).

relevant to the study of corporations, partnerships and limited liability companies.¹²⁷

IV. THE GENERAL THEORY OF GROUPS

A. *The Nature of Groups*

The debate over the nature of the corporation has paralleled and borrowed from the literature of philosophy, sociology, and social psychology. These disciplines have each taken a long look at the nature of groups and the nature of individuals in groups. For example, theorists of corporate personality have generally argued about whether a legal person (other than a human being) is an artificial or an organic entity. There is a similar debate in the theoretical literature about the difference between artificial and organic groups generally.¹²⁸ An organic group is one which takes on characteristics of its own and becomes more than the sum of the individual members.¹²⁹ Many theorists argue that there is a "purposive group" where the members share a "specific mental state."¹³⁰ The members of such groups share the common understanding that they are acting as a group in furtherance of a specific goal or, in other words, they are a "plural

¹²⁷Limited liability companies are also defined by statute as "entities," and courts have treated them that way. There is little case law and no commentary relating to the nature of the LLC entity. The entity theory pertaining to LLCs might resemble that of corporations, since the features that distinguish LLCs from partnerships, such as unlimited life, limited liability and centralized management, arguably relate to the fact that LLCs are legally defined as entities. Alternatively, member-managed LLCs, in which all members are agents of the LLC, might be treated as partnerships while manager-managed LLCs are treated as corporations.

¹²⁸See generally MARGARET GILBERT, ON SOCIAL FACTS 1-7 (1989) (examining collectivity concepts); John M. Levine & Richard L. Moreland, *Small Groups*, in II DANIEL T. GILBERT ET AL., THE HANDBOOK OF SOCIAL PSYCHOLOGY 415 (1998) (explaining groups and social behavior). See also Maitland, *supra* note 83, at 306, 314, 318-19 (arguing that groups are moral, not fictitious, units). On the artificial/organic debate with respect to corporations, see HORWITZ, *supra* note 72, at 71, 75, 100-05; Laski, *supra* note 84, at 405-07; Maitland, *supra* note 83, at 318-19. The artificial/organic distinction has not generally been applied to partnerships. Crane's criticism of Lewis on the basis of Lewis's belief that legal persons are "fictitious" may be a rare exception to this pattern, but it is not clear that Crane is arguing for an organic conception of the partnership. See Crane, *Legal Persons*, *supra* note 91, at 846-47.

¹²⁹One of the leading proponents of the existence of such groups is Otto von Gierke. See generally VON GIERKE, *supra* note 83; Maitland, *supra* note 83. See also FREUND, *supra* note 87, § 1; HALLIS, *supra* note 70, at 9, 119.

¹³⁰See GILBERT, *supra* note 128, at 13, 15, 146. I have given the term "purposive group" my own definition, although others have used it in a similar sense. See WILLIAM MCDUGALL, THE GROUP MIND 123-25 (2d ed. 1920). Von Gierke terms this type of group a *genossenschaft*, which is usually translated "fellowship." See Maitland, *supra* note 83, at xxv; von Gierke, *supra* note 7, at 59.

subject.¹³¹ The idea of a common goal or purpose is an essential element to group theory.¹³² A collection of individuals without such a purpose is merely a crowd.¹³³ When a number of individuals with a shared goal decide to associate in order to achieve that goal — where the association is a means to attaining the goal — they have formed a purposive group.¹³⁴ In addition to a shared goal, a purposive group has a "collective intentionality" that requires cooperation to achieve the common goal.¹³⁵ Members of the group have an obligation to "join forces" to attain or be jointly responsible for the goal.¹³⁶ Other theorists have identified this feature as an emotional bond between the members of the group and the group itself.¹³⁷ An example of a purposive group is a football team. The team's goal is to get the ball across the goal line, but each individual member also has his own goals — to block a pass, to tackle a runner, to carry the ball for ten yards, etc.¹³⁸ Each individual's personal goal, however, even if shared by all the group's members, is not sufficient to create a purposive group, unless there is

¹³¹GILBERT, *supra* note 128, at 13, 15, 146.

¹³²See VON GIERKE, *supra* note 83, at 120-21, 190, 196-97, 206-08; HALLIS, *supra* note 70, at 35, 90, 101; MCDUGALL, *supra* note 130, at 83, 124-25; 24 MANCUR OLSON, JR., *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* 7-8 (1965).

¹³³See FREUND, *supra* note 87, § 11; HALLIS, *supra* note 70, at 119; MCDUGALL, *supra* note 130, at 67.

¹³⁴See MCDUGALL, *supra* note 130, at 83. See also 2 ALEXIS DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* 107-09 (Henry Reeve & Francis Bowen trans., Phillips Bradley ed., 1945) (discussing the American tendency to form associations to "pursu[e] in common the object of their common desires"). Economic theory suggests that only certain groups will meet this definition, based on whether the members have an incentive to act in the group's interest. See also OLSON, *supra* note 132, at 2 (arguing that individuals in groups will not act to further the interest of the group, even if to do so will also further their own interest, unless there is coercion or some incentive other than derivative benefit as the group benefits, because the rational thing for any individual to do is not to so act); *id.* at 23-27, 44-45 (discussing incentives generally); *id.* at 27-28, 33-34 (discussing dynamics in small groups); *id.* at 36, 46-47 (discussing unlikelihood of cooperative action in large groups), *id.* at 57-59 (rejecting group theory that extrapolates from small to large groups).

¹³⁵See JOHN R. SEARLE, *THE CONSTRUCTION OF SOCIAL REALITY* 23-26 (1995); VON GIERKE, *supra* note 83, at 190, 196-97, 199, 206-08; John R. Searle, *Collective Intentions and Actions*, in *INTENTIONS IN COMMUNICATION* 401, 406 (Philip R. Cohen et al. eds., 1990).

¹³⁶See GILBERT, *supra* note 128, at 163; VON GIERKE, *supra* note 83, at 106; Maitland, *supra* note 83, at 25, 27. But see OLSON, *supra* note 132, at 2, 23-27 (arguing that individuals will not cooperate to attain a group goal in many circumstances).

¹³⁷See GILBERT, *supra* note 128, at 223-25 (discussing feelings of harmony and communion); MCDUGALL, *supra* note 130, at 77-80 (discussing the "common sentiment" of the group); *id.* at 87 (discussing *esprit de corps*); Levine & Moreland, *supra* note 128, at 416-17 (describing "social integration").

¹³⁸See Searle, *supra* note 135, at 38, at 404. Cf. Pfeffer, *supra* note 124, at 734 (arguing that the definition of an "organization" based on its pursuit of a specific goal is problematic because its individual members will have different goals: a firm's goal is to maximize shareholder value, while an employee's individual goal is job security).

cooperation among the members of the group.¹³⁹ Eleven individuals, each trying to get a ball across a goal line, does not constitute a football team. A purposive group is thus characterized by the combination of its shared goal and its cooperative method.

Some theorists also argue that purposive groups develop a collective identity or "group mind" that is created by the individuals in the group, yet separate from it.¹⁴⁰ The existence of a group mind is allegedly demonstrated by the way in which people think about such groups. For example, one speaks of a church as believing and acting in the singular.¹⁴¹ Furthermore, the fact that the interests of the group can conflict with the interests of the individual members is said to indicate the existence of a "group mind."¹⁴² The simplistic conception of the group mind as a social force, sometimes called "groupthink," has largely been abandoned. Nevertheless, in a less formalistic and more subtle way, people continue to think of groups as having their own interests and purposes separate from those of its members.

While group theorists are concerned with groups of all sorts and are not particularly interested in legal concepts, their observations are striking when read with business enterprises in mind.¹⁴³ A business association necessarily is a purposive group in the sense that individuals have combined to achieve some common purpose.¹⁴⁴ In purposive groups, for example, just as in corporations and partnerships, a single individual may be a member of more than one group, and the same set of individuals may constitute more than one group.¹⁴⁵ Similarly, establishing a group for one purpose does not

¹³⁹See Searle, *supra* note 135, at 406. Cf. Lon L. Fuller, *Two Principles of Human Association*, in NOMOS XI: VOLUNTARY ASSOCIATIONS 3-8 (J. Roland Pennock & John W. Chapman eds., 1969) (arguing that there are two types of groups, those defined by a shared commitment, such as a commitment to act together, and those defined by legal principles or rules).

¹⁴⁰See MCDUGALL, *supra* note 130, at 13; VON GIERKE, *supra* note 83, at 242-43; Levine & Moreland, *supra* note 128, at 417.

¹⁴¹See HALLIS *supra* note 70, at 95; MCDUGALL, *supra* note 130, at 25; Maitland, *supra* note 83, at xli.

¹⁴²See MCDUGALL, *supra* note 130, at 21. Other theorists have rejected the concept of a group mind. See, e.g., HALLIS, *supra* note 70, at 114, 125-26, 155, 232

¹⁴³But cf. Laski, *supra* note 84, at 410, 412-13, 418 (arguing that using purpose to define corporateness is too restrictive); *id.* at 423-24 (arguing that personality derives from will, not purpose). There is no reason to assume that all purposive groups will be legal persons. On the contrary, many such groups exist that have no legal status at all, such as social clubs and amateur athletic teams.

¹⁴⁴Philosophers call this a "social fact." See SEARLE, *supra* note 135, at 26. Social facts are expressions of human understanding operating as "placeholders for patterns of activities." *Id.* at 57.

¹⁴⁵See GILBERT, *supra* note 128, at 220. Cf. Lewis, *supra* note 82, at 159-60; VON GIERKE, *supra* note 83, at 23.

necessitate establishing a group for other purposes as well.¹⁴⁶ The shareholders of a widget-maker are not involved in a landscaping business, even if they all mow their own lawns. Corporations act as purposive groups: they speak with one voice,¹⁴⁷ they pursue one goal¹⁴⁸ and they have interests distinct from those of their shareholders.¹⁴⁹ The cooperative nature of the corporate enterprise is evidenced by the fact that, historically, one of its most important functions was as a means to accumulate capital.¹⁵⁰

The "other constituency" debate in corporate law is a question of the identity of the members of the group: is the group composed only of shareholders,¹⁵¹ or are employees, customers and others also part of the group? Since a group is formed by a constitutive act,¹⁵² the group must consist only of the shareholders, as successors of the original organizers of the group (the promoters and subscribers).¹⁵³ The interests of the shareholders conform with those of the corporate group, with each shareholder determined to increase corporate profitability.¹⁵⁴ The fact that the members of a corporate group often do not control who the other

¹⁴⁶See GILBERT, *supra* note 128, at 221. Cf. Lewis, *supra* note 82, at 159-60; VON GIERKE, *supra* note 83, at 23, 120-21.

¹⁴⁷See HALLIS, *supra* note 70, at 95; HENN & ALEXANDER, *supra* note 42, at 145-46; Carr, *supra* note 114, at 169-70, 172; Dodd, *supra* note 111, at 1160.

¹⁴⁸See Berle, *supra* note 112, at 354 (arguing that "below" a corporation's legal documents "there is always an enterprise").

¹⁴⁹See HENN & ALEXANDER, *supra* note 42, at 146; Carr, *supra* note 114, at 172; Johnson, *supra* note 70, at 932.

¹⁵⁰See JOSEPH K. ANGELL & SAMUEL AMES, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS AGGREGATE § 2 (3d ed. 1846); HENRY WINTHROP BALLANTINE, BALLANTINE ON CORPORATIONS § 1 (1927). See also VON GIERKE, *supra* note 83, at 190, 196-98, 206-08 (discussing difference between personal fellowships, in which people come together to create a relationship, and capital fellowships, in which property is brought together to be acted upon).

¹⁵¹I use the term "shareholders" to mean holders of common and preferred stock, whatever the rights of such shares may be. Fully redeemable preferred stock may be better characterized as debt, however.

¹⁵²See MCDUGALL, *supra* note 130, at 68-70, 124; VON GIERKE, *supra* note 83, at 199; Berle, *supra* note 112, at 347; von Gierke, *supra* note 7, at 152-53, 155.

¹⁵³In this respect, the purposive group theory of the business association differs radically from the team production theory, which views the corporation as a hierarchy "in which several different groups contribute . . . resources to the corporate enterprise." Blair & Stout, *supra* note 5, at 275.

¹⁵⁴See Berle, *supra* note 112, at 355. This is even true, in theory, where a corporate raider offers a substantial premium for the shares of the corporation. Market theory suggests that, if the premium is substantial enough to encourage the shareholders to sell, then the corporation must be worth more, and thus will be better off (in the sense that it will be better managed), in the hands of the acquirer. See CLARK, *supra* note 38, § 13.2, at 533-35; Marcel Kahan & Michael Klausner, *Lockups and the Market for Corporate Control*, 48 STAN. L. REV. 1539, 1541-42 (1996). In theory, this will be true even if the acquirer plans to break up the corporation. See CLARK, *supra* note 38, § 13.2, at 539.

members are (because shares are freely transferable) does not destroy the collective nature of the group since all members (via stock ownership) presumptively have the same purpose in mind.¹⁵⁵ Additionally, new shareholders are procedurally part of the group because they are subject to the same corporate charter.

The position of customers, creditors, suppliers, and the community at large, vis-a-vis the corporation, is different. Such persons cannot be members of the corporate group because their purpose is not the same as that of the shareholders. They may hope that the corporate enterprise is successful, but only because that success will advance some other goal. A creditor will happily accept a corporation's liquidation if the creditor will be repaid, even if that is not in the best interests of the corporation. Similarly, the customers of the local hardware store are interested in its success only until a competitor with lower prices opens a store nearby. For such other constituencies, the corporation's success is only a means to an end, which is the real purpose and enterprise of that constituency.

Holders of derivative securities are also not members of the group. Some derivatives, such as put options, increase in value as the share price of the underlying equity security declines. Holders of such securities by definition are not members of the group because their interests are directly opposed to those of the shareholders. On the other hand, holders of securities whose value is directly correlated with the share price, such as warrants, are also not members of the group because they do not have the same purpose as the regular equity holders. One might say that such holders have entered into the corporate enterprise half-heartedly. They are not parties to the constituent agreements of the group and they usually have rights and powers that the equity holders do not have. In essence, what makes the security a derivative and gives it value is its difference from the basic equity securities. Thus, derivative holders are necessarily separated from the group of equity holders.

Employees are also not members of the corporate group. Similar to shareholders, their economic self-interest generally coincides with the financial interest of the corporation, and they will generally elect to leave the group if another opportunity is more attractive. Nevertheless, employees are not members of the corporate group for a number of reasons. First, a corporation is not created by employees joining together to constitute a

¹⁵⁵See HALLIS, *supra* note 70, at 228 (describing "[t]he group of those interested in the idea of corporate enterprise, who are one with the corporate person [and] participate in the government of the institution"). Glenn v. Hoteltron Sys., Inc., 547 N.E.2d 71, 73 (N.Y. 1989).

group based on a common purpose.¹⁵⁶ Second, the advancement of the corporate group's purpose may, but need not, advance the interests of the employees, while corporate success *necessarily* advances the interests of the shareholders. Third, although shareholders do not have the power to control the identity of the other shareholders in many corporations,¹⁵⁷ they do have the power to control the terms under which new shareholders join because share ownership is governed by the corporate charter, which can only be amended by shareholder vote.¹⁵⁸ Employees, on the other hand, are hired and fired by other employees, and neither the shareholders nor the other employees, as a group, have any control over the identity of the employees or the terms of their employment.¹⁵⁹ The fact that employees are not members of the group is reflected in the widespread use of incentive stock options and other policies to encourage and facilitate employee stock ownership. Such programs are designed to give employees a direct stake in the corporate enterprise, or, in other words, to unite the employees with the other shareholders and make them members of the group.

Although the natural entity theory has never been applied to partnerships, a partnership, whether *legally* an aggregate or an entity, is also a purposive group.¹⁶⁰ A partnership involves carrying on a "business for profit."¹⁶¹ The official comment to RUPA describes a business as "a series of acts directed toward an end."¹⁶² A partnership is, therefore, at a minimum

¹⁵⁶Employees might form such a group, of course, but it would probably be a labor union or a "cooperative," such as a credit union. Or, such employees might form a close corporation, in which case they are members of the corporate group by virtue of being shareholders.

¹⁵⁷Free transferability of shares is one of the hallmarks of corporateness, see 11 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF CORPORATIONS § 5082 (Victoria A. Braucher et al. eds.) (perm. ed. rev. vol. 1995), although in closely-held corporations shareholders usually restrict transferability (and thus group membership) by contract.

¹⁵⁸See DEL. GEN. CORP. L. §§ 102, 151, 242 (2001); N.Y. BUS. CORP. L. § 803 (1977); REV. MODEL BUS. CORP. ACT §§ 2.02, 6.01, 10.01-10.09 (1999).

¹⁵⁹In closely-held corporations, the shareholders may in fact exercise such a power, but they do so as managers, not as shareholders. Because officers are by law selected by the board, and because the board is obligated to exercise its judgment to act in the best interests of the corporation, the shareholders generally may not bind the directors by contract to elect certain persons as officers unless all the shareholders agree. See *Galler v. Galler*, 203 N.E.2d 577 (Ill. 1964); *Clark v. Dodge*, 199 N.E. 641 (N.Y. 1936); *McQuade v. Stoneham*, 189 N.E. 234 (N.Y. 1934). See generally Annotation, *Validity and Effect of Agreement Controlling the Vote of Corporate Stock*, 45 A.L.R.2d 799, § 5 (1956). See also FREUND, *supra* note 87, §§ 20-21 (discussing role differentiation in groups).

¹⁶⁰See Maitland, *supra* note 83, at xxii.

¹⁶¹UPA § 6(1); RUPA § 202(a). See also PARSONS, *supra* note 68, at 1 (defining a partnership as "a legal entity formed by the association of two or more persons for the purpose of carrying on business together and dividing its profits between them").

¹⁶²RUPA § 202, cmt. 1.

and by definition, a group whose goal is to carry on a business.¹⁶³ Fiduciary duties generally are owed to the partners *as owners of* the business, and not to the partners in any other sense.¹⁶⁴ Furthermore, a partnership is a cooperative effort.¹⁶⁵ There would be no point in forming a partnership, and thereby subjecting oneself to liability for the acts of others, if one did not intend to benefit from such cooperative efforts. This is one of the reasons some courts treat closely held corporations differently from publicly held ones. If the expectation of the members is that the partnership will be run cooperatively, partnership fiduciary duties owed *between* the shareholders, will be imposed.¹⁶⁶

The interesting and perhaps novel feature of the elaboration of group theory is that it identifies the relationship between the group's interests, on the one hand, and the individual's separate interests, on the other. In a purposive group, each member serves both her own interests and those of the group, because the individual's and the group's interests are linked, at least with respect to the attainment of the group's goal.¹⁶⁷ Similarly, in a partnership, a partner's pursuit of her own self-interest, *at the expense of the partnership*, would injure her own interests as a partner.¹⁶⁸ The cooperative nature of a partnership, therefore, distinguishes it from a buyer-seller

¹⁶³It may, at times, require considerable effort to determine what a partnership's specific purpose is. There is, however, a large body of case law devoted to determining partnership purposes and the scope of a partnership's business, and this is the sort of inquiry courts are perfectly capable of performing. *See, e.g.,* Shawn v. England, 570 P.2d 628, 630 (Okla. App. 1977) (holding that a partnership did exist for the purpose of developing a weather book even though an earlier idea was abandoned). *See also* BROMBERG & RUBSTEIN, *supra* note 4, § 6.07(d) nn.76-79 (discussing factors used in determining when an opportunity is a partnership opportunity); *id.* § 6.07(e) nn.96-98 (same with respect to competition with partnership).

¹⁶⁴*See supra* notes 16-17 and accompanying text.

¹⁶⁵*See* FREUND, *supra* note 87, § 16.

¹⁶⁶*See* Merola v. Exergen Corp., 668 N.E.2d 351 (Mass. 1996) (noting that shareholders in a close corporation owe each other a fiduciary duty); Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657 (Mass. 1976) (holding that majority shareholders violated their fiduciary duty because they had no legitimate business purpose for their actions and because they violated their own policies).

¹⁶⁷*See* RUDOLF VON JHERING, LAW AS A MEANS TO AN END (Isaak Husik trans. 1913), reprinted in 5 THE MODERN LEGAL PHILOSOPHY SERIES 95, 160-62 (Ass'n. of Am. L. Schs. ed., Rothman reprints 1968) (noting that in order for a partnership to be successful, the partners must recognize the interrelation of their interests); PARSONS, *supra* note 68, at 41. The individual's interests need not be the same as the group's. It is only necessary that advancing the interests of the group (e.g., carrying on its business) also advances the interests of the individual (e.g., receiving a return on one's investment). *See* SEARLE, *supra* note 135, at 38 (noting that each individual's contribution will have a "different intentional content from the collective intentionality").

¹⁶⁸VON JHERING, *supra* note 167, at 160-62 (stating that a selfish partner goes "against the basic idea of the whole institution . . . [and] is an enemy in one's own camp").

relationship, justifies mutual and unlimited liability, and justifies the existence of fiduciary duties.¹⁶⁹

B. *The Functioning of Groups Generally*

Social psychologists have studied the workings of purposive groups, including business associations. Not surprisingly, they have discovered that small groups tend to be more closely integrated than large groups, and the members of small groups tend to devote more effort to the group's purpose.¹⁷⁰ Also not surprisingly, people form groups only when involvement in the group is more attractive than not being involved in the group.¹⁷¹ If there is a greater benefit from being associated with a limited part of a group (with only some members of the group), as opposed to associating with the full group, a new group or a subgroup will be formed.¹⁷²

Once a purposive group is formed, it will function in certain predictable ways. Conflicts between the individual interests of the members and the interests of the group may lead to the formation of coalitions or to the creation of subgroups, which may eventually break away from the group.¹⁷³ Power relationships within the group will be affected by the extent to which the individualized interests of the members coincide or differ.¹⁷⁴ Where the interests of some members of a group coincide more closely than the interests of others, coalitions form.¹⁷⁵ Groups will often develop behavioral norms, find ways to enforce those norms,¹⁷⁶ and develop specific

¹⁶⁹See Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 802 (1983) (linking fiduciary duties to cooperation and identity of interest); Mitchell, *supra* note 23, at 484-86 (discussing the way fiduciary duties encourage cooperative behavior); Donald J. Weidner, *RUPA and Fiduciary Duty: The Texture of Relationship*, 58 LAW & CONTEMP. PROBS. 81, 90-93 (1995) (arguing that fiduciary duties are part of an interrelated set of partnership rights and duties).

¹⁷⁰See DE TOCQUEVILLE, *supra* note 134, at 107-08 (discussing the effectiveness of a small aristocracy versus a large democratic nation); MCDUGALL, *supra* note 130, at 117 (discussing the advantages of smaller groups); OLSON, *supra* note 132, at 28, 33-35 (discussing dynamics in small groups); *id.* at 36, 46 (discussing unlikelihood of cooperative action in large groups); *id.* at 57-59 (rejecting group theory that extrapolates from small to large groups); Levine & Moreland, *supra* note 128, at 422 (discussing how group size affects group structure, member participation, group dynamics, conformity level, coordination, and motivation).

¹⁷¹See JOHN W. THIBAUT & HAROLD H. KELLEY, *THE SOCIAL PSYCHOLOGY OF GROUPS* 192-95 (1959). As Thibaut and Kelley describe it, people will form a group only if $CL > CL_n$ (where CL is the "comparison level" for participation in the group and CL_n is the comparison level for the best alternate arrangement). *Id.* at 192.

¹⁷²See *id.* at 192-95.

¹⁷³See *id.*

¹⁷⁴See *id.* at 198-205.

¹⁷⁵See THIBAUT & KELLEY, *supra* note 171, at 205.

¹⁷⁶See *id.* at 239, 254-55.

group goals intended to advance the group's purpose.¹⁷⁷ The group's norms and goals are based on consensus, but not necessarily on unanimity. Members will act to achieve goals even if they did not initially support the goal, especially in highly cohesive groups, because the members closely identify with the group.¹⁷⁸

C. Identification and Articulation of Group Interests

To characterize the fiduciary duties owed to a business association, one must be able to identify a single set of group interests. Fiduciary duties present a problem in the business context precisely because it is difficult to identify the *group's* interests, as opposed to those of the individuals composing the group.¹⁷⁹ In a publicly traded corporation, for example, the shareholders' individual interests pertain to the price of the stock.¹⁸⁰ The interest of the corporate group, on the other hand, is usually to maximize its profits by improving its business, although this is not the case when the corporation's business prospects do not justify the continuation of the business.¹⁸¹ Under general incorporation statutes and partnership law, the organizers of a business association are not required to state their purpose when they form a group. In addition, the association may develop other interests over time. Because the duties of the association's fiduciaries depend upon identifying its interests, the law must provide a means of interest-identification.

The theoretical literature about purposive groups also helps with identifying group interests. Each group will have an "organ" that is composed of one or more representative individuals who are empowered to

¹⁷⁷See *id.* at 257-60.

¹⁷⁸See *id.*

¹⁷⁹For a discussion of this point, see FREUND, *supra* note 87, §§ 7-8.

¹⁸⁰Usually the stock price is the shareholder's only concern, and differences among shareholders relate either to their personal investment positions (such as their tax situations or their investment horizons) or to disagreements among them about how to maximize the stock price (by encouraging an acquisition, for example). In rare cases, a shareholder may have individual interests not related to the share price. See *Coggins v. New England Patriots Football Club, Inc.* 492 N.E.2d 1112, 1115 (Mass. 1986) (shareholder objected to cash-out merger because he took "special pride in his status as owner" of football team).

¹⁸¹Where the business must be terminated, the corporation's interest will be served by maximizing the price the owners of the business will realize. This understanding of the corporation's interests is embodied in the so-called *Revlon* doctrine. See also VON GIERKE, *supra* note 83, at 198-99 ("Collective will gives [the corporation] its constitution, its law of existence; and within the bounds of this constitution, it is a collective will which in the first instance controls any changes in, and the final dissolution of, the organism.").

speak for the group.¹⁸² The primary representative of any purposive group is "the assembly of fully-enfranchised members."¹⁸³ There is also a smaller organ to administer and represent the group, that "in practice generally arranges the actual direction of the common association business."¹⁸⁴ The organ represents the group in a more complete sense than an agent represents a principal, because, unlike the principal in the usual principal-agent relationship, the group *cannot* speak for itself.¹⁸⁵ Through the organ, the group is able to act as a single entity.¹⁸⁶ The notion that a group may speak through a duly-constituted representative body is a common feature of American law. In a representative democracy, for example, the representatives are said to "pronounce" the public voice.¹⁸⁷ The way in which the organ is selected, the limits of its authority, and its accountability to the full group will be determined by agreement at the time of the group's formation through the association's constitution or, in the absence of agreement, by the law.¹⁸⁸

¹⁸²See HALLIS, *supra* note 70, at 156 (discussing von Gierke's position that "the collective will requires an *organ*, i.e., a human will, for its expression"); HENRY M. HART, JR. & ALBERT M. SACKS, *THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW* 8 (William N. Eskridge, Jr. & Philip P. Frickey eds., 1994) ("[I]f it is impossible or thought undesirable for all the members of the group to assemble together, the only recourse is the designation of a representative to act in their behalf, namely, officials."). See also HART & SACKS, *supra*, at 3 (discussing the need, in general purpose groups such as communities, for both substantive and procedural (or constitutive) arrangements and understandings).

¹⁸³Von Gierke, *supra* note 83, at 200. See also Maitland, *supra* note 83, at 64-66 (describing early concepts of representative assemblies acting for the whole community and the legitimizing force of elections).

¹⁸⁴VON GIERKE, *supra* note 83, at 201.

¹⁸⁵See, e.g., FREUND, *supra* note 87, § 13 (arguing that representative organ of the group is original, not delegated); Maitland, *supra* note 84, at xx (stating that since the corporation is "a mindless being that can do no act, we must not think of the organized group of corporators as an 'agent' appointed by a somewhat inert 'principal'").

¹⁸⁶See HALLIS, *supra* note 70, at 103 ("[T]he most significant feature about the organ of a collectivity [is] that it acts and speaks *as* the collectivity."); von Gierke, *supra* note 7, at 153 ("Through the organ, then, the invisible collective person appears as a perceptive, deliberating, willing, and acting unity.").

¹⁸⁷See THE FEDERALIST No. 10, at 62 (James Madison) (Jacob E. Cooke ed., 1961).

¹⁸⁸Von Gierke argued that law must regulate the internal workings — the constitution — of the group. Members are allotted positions in the group, with "a single member perhaps acknowledged as the legal head."

A vast complex of principles, extremely different for the different societies and often very involved, serves to establish the number and type of organs, to grant to each of them a definite sphere of activity as competence or duty, to regulate the relation of the organs among themselves, to insure their cooperation and the direction of lower organs by higher organs up to the highest organ, to define the form of procedure for exercising organic functions, and to adapt these functions to their purpose. Therefore, legal principles extend to the formation of the organ by the single person or group of persons designated for the time being to act as the

The organ's power to act and speak for the group is limited both procedurally and substantively. Procedurally, the organ may be selected by the group in a way (such as periodic elections) that makes the organ accountable to the full group.¹⁸⁹ Additionally, the group may create an incentive structure (such as stock options) that aligns the self-interest of the members of the organ with the interests of the group as a whole.¹⁹⁰ In partnership and corporate law, the power of the organ is limited substantively by legal doctrines on authority (such as *ultra vires* corporate acts) and by fiduciary duties.¹⁹¹ Thus, the law of fiduciary duties must provide some check on the organ's power to act; otherwise, the organ's naked assertion that an act was in the group's interest would necessarily defeat any claim for breach of duty. For example, the law generally leaves the identification of the corporation's interests to its managers. This is one of the features of the business judgment rule, which presumes that acts taken by a board of directors are taken with the best interests of the corporation in mind. Because the courts will not inquire into an action that can be "attributed to any rational business purpose,"¹⁹² the officers and directors of the corporation have wide latitude to determine the corporation's interests. The rule is usually justified as a recognition of the practical difficulties of having courts decide, after the fact, whether an act taken in the course of managing a business was the best decision at the time. In fact, the rule is a recognition of a basic fact of group operation. One of the primary duties of the organ of a group is to identify the group's interests, and therefore acts

organ, to the acquisition or loss of this position, and to the relation of the organic personality to the individual personality of the participants.

Von Gierke, *supra* note 7, at 153.

¹⁸⁹The ability of the group to ensure that the members' views are brought to the attention of the "organ" is a fundamental requirement in political society as well as in business associations. See Jürgen Habermas, *Paradigms of Law* (William Rehg trans.), in *HABERMAS ON LAW AND DEMOCRACY: CRITICAL EXCHANGES* 13, 18-19 (Michel Rosenfeld & Andrew Arato eds., 1998) (discussing the "proceduralist paradigm," which depends upon citizens' participating in "political communication in order to articulate their wants and needs, to give voice to their violated interests, and, above all, to clarify and settle the contested standards and criteria according to which equals are treated equally and unequals unequally"). See also WILLIAM N. ESKRIDGE, JR., *DYNAMIC STATUTORY INTERPRETATION* 143 (1994) ("The genius of legal process theory is its ability to mediate substantive divisions through procedure and to press the polity toward new consensus over time."); FREUND, *supra* note 87, § 19 (arguing that the "rational explanation" for due process considerations in corporate law is to increase the psychological bond between members of the group).

¹⁹⁰The design of the House of Representatives involves similar principles: accountability is ensured by frequent elections, and the fact that the representatives can make no law not binding on themselves will provide them with a "communion of interests" with the public. See *THE FEDERALIST* No. 57, at 386 (James Madison) (Jacob E. Cooke ed., 1961).

¹⁹¹For a general discussion of this point, see FREUND, *supra* note 87, § 18.

¹⁹²*Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

taken by that organ must, in the ordinary case, be in the interests of the group. In the extraordinary case, however, such as where the act benefits the representatives, the power of those representatives to define the interests of the group is reduced or eliminated, and another party such as a court, other members of the full group, or a receiver, must step up to identify the group's interests. The rule also does not protect decisions taken without sufficient information or deliberation,¹⁹³ and it thus enforces a norm of reasoned decision-making when the organ is acting to identify and implement the group's interest. Additionally, there is considerable case law discussing the nature of legitimate corporate interests in the takeover context, where identification of the group's interests is controversial and where the business judgment rule therefore frequently does not apply.¹⁹⁴

Since a purposive group is defined by its purpose, the organ's acts, to be legitimate, must, at a minimum, advance that purpose.¹⁹⁵ It is the purpose that creates the group and leads to the constitution of both the group and the organ,¹⁹⁶ and it is because the organ's acts advance the collective purpose that they are, in a real sense, the acts of the group.¹⁹⁷ Thus, the law must be able to clearly identify a group's purpose. Furthermore, even where the original purpose of the group is clearly articulated, that purpose may and probably

¹⁹³See *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (refusing to apply business judgment rule where action was not taken with sufficient deliberation).

¹⁹⁴An in-depth analysis of the application of the business judgment rule and directors' duties generally in the takeover context is beyond the scope of the article. Interested readers should consult BLOCKET AL., *supra* note 13. See also ALI PRINCIPLES OF CORPORATE GOVERNANCE § 4.01 (1994) (stating the business judgment rule and how it is applied).

¹⁹⁵The determination of a course of action (the need for a will) must relate to the corporate purpose, because, as Hallis puts it, the power of will is "at the service of a directing idea." See HALLIS, *supra* note 70, at 225. See also FREUND, *supra* note 87, § 8 (arguing that the organ's power of control in a corporation must be limited to the requirements of the underlying interests).

¹⁹⁶See VON GIERKE, *supra* note 83, at 198-99.

[T]he very *existence* of a joint-stock company is by no means determined by the original capital sums alone, but in addition by a personal *collective will*. Collective will brings the corporation into existence by a constitutive act (which has been falsely construed as a contract and is still called "company contract" [*Gesellschaftsvertrag*] in the trade statute book) and in the *articles*. Collective will gives it its constitution, its law of existence; and within the bounds of this constitution, it is a collective will which in the first instance controls any changes in, and the final dissolution of, the organism.

Id.

¹⁹⁷See VON GIERKE, *supra* note 83, at xix (noting that, when people form groups freely and voluntarily, "common purposes bind together the leader or executive committee and the association as a whole, the former acting as the 'organ' of the latter"). See also FREUND, *supra* note 87, § 14 (discussing generally the idea of "original representation"); GILBERT, *supra* note 128, at 206-07 (arguing that after there is an "authorized representative of the group as a whole members of the group jointly accept that certain decisions of a certain few are to count as our decisions").

will change over time.¹⁹⁸ One of the roles of law is to enable a group's purpose to evolve so as to prevent the purpose from ossifying.¹⁹⁹

Fortunately, identifying a group's purpose is not an activity that is foreign to the law. The factors to be considered in determining the purpose of a partnership are relatively clear,²⁰⁰ and the well-developed law relating to corporate fiduciary duties and the business judgment rule address the limits of a corporate organ's identification of the corporate purpose.²⁰¹ Interpreting "purpose" is also an activity familiar to statutory interpretation. The "purposive" school, for example, seeks to determine the purpose of legislation as a guide to its interpretation.²⁰² As Hart and Sacks wrote, in any social organization a decision maker must choose among several purposes to be pursued by the organization.²⁰³ Similarly, in statutory interpretation, the judge must determine the purpose of the legislation, which is subject to change over time.²⁰⁴ The determination is based on a number of considerations, including statements of purpose in the text of the legislation,²⁰⁵ the "mischief" that the statute was intended to remedy,²⁰⁶ and any prior accepted attribution of purpose by the legislature, the public, state

¹⁹⁸See HALLIS, *supra* note 70, at 102 (noting that "judges will . . . have to take into consideration, in judging the activities of [an] association, not merely its purpose but also the wills behind that purpose"). See also Ernest Barker, *Translator's Introduction* to OTTO GIERKE, *NATURAL LAW AND THE THEORY OF SOCIETY, 1500-1800*, at lxxvii (Ernest Barker trans., 1950) (discussing Gierke's argument that the purpose for which a group is formed is a "real purpose . . . which continuously moves and animates the members of the group . . . But ideas, if they are to live, must also change, since change is part of life").

¹⁹⁹See HALLIS, *supra* note 70, at 184 (arguing that the static conception of a corporation does not take into account the underlying social reality that a corporation "is a group of human beings who are ever changing in their corporate life, evolving new corporate interests, and so changing both the internal and external relations of the corporate body"); Barker, *supra* note 198, at lxxviii-lxxix. See also HART & SACKS, *supra* note 182, at 3 (arguing that people in groups "need understandings about the kinds of conduct which must be avoided if cooperation is to be maintained . . . [and] they need understandings about the kinds of affirmative conduct which is required if each member of the community is to make his due contribution to the common interest").

²⁰⁰See *supra* note 163. Courts also consider the "purpose" of persons entering into deeds and contracts. See, e.g., *El Di, Inc. v. Town of Bethany Beach*, 477 A.2d 1066, 1069-70 (Del. 1984) (considering purpose of restrictive covenant in determining whether the benefits thereof were still capable of enjoyment).

²⁰¹See *supra* note 194 and accompanying text.

²⁰²The purpose of legislation is distinguished from legislative intent in that purpose is more general and can be determined from the text of the legislation, as opposed to archaeological evidence such as legislative history. See ESKRIDGE, *supra* note 189, at 25-34 (1994); HART & SACKS, *supra* note 182, at 1228-33, 1377-80.

²⁰³See HART & SACKS, *supra* note 182, at 108.

²⁰⁴See ESKRIDGE, *supra* note 189, at 30-31; HART & SACKS, *supra* note 182, at 148.

²⁰⁵See HART & SACKS, *supra* note 182, at 1377.

²⁰⁶See *id.* at 1378.

agencies, or the judiciary.²⁰⁷ The role of the judge in statutory interpretation is analogous to that of a "platoon commander following orders in battle,"²⁰⁸ or of the "relational agent," who "is supposed to follow the general directives embodied in the [principal-agent] contract and the specific orders given [to] her by the principal, but her primary objective is to use her best efforts to carry out the general goals and specific orders over time."²⁰⁹ Similarly, a board of directors must use its judgment, based on the original purpose for which the company was formed and its subsequent history, to determine the company's interests. A judge assessing the board's acts must do the same.

In fact, the problem of identifying group interests is not different in kind from the problem of identifying an individual's interests. Individuals often have multiple and conflicting interests,²¹⁰ and it is sometimes difficult for a fiduciary to know what the individual's interests are, especially when the beneficiary is incompetent or an infant.²¹¹ In some cases, the law establishes guidelines for fiduciaries, the "best interests of the child" standard.²¹² Where a child is unable to identify and articulate her own interests, a guardian *ad litem* or judge must make that determination pursuant to guidelines developed statutorily and through case law.²¹³ Additionally, children's expressed interests may conflict with their "best

²⁰⁷*See id.* at 1379.

²⁰⁸ESKRIDGE, *supra* note 189, at 124 (citing RICHARD A. POSNER, *THE PROBLEMS OF JURISPRUDENCE* 269-73 (1990)). The commander "must go beyond – and sometimes even against – existing orders to ensure the success of the overall battle plan." *Id.* As time passes, the commander's role becomes increasingly difficult. *Id.* at 125.

²⁰⁹*Id.* at 125.

²¹⁰*See* HALLIS, *supra* note 70, at 224 (comparing the psychological state of the individual with that of the corporation); FREUND, *supra* note 87, § 8 (discussing the necessity and benefits of placing the interests of one person in the control of another); MCDUGALL, *supra* note 130, at 14 (stating that "[t]he individual mind . . . is by no means always a harmonious system").

²¹¹*See* MAITLAND, *supra* note 83, at xx (noting that the relationship between a corporation and its board is analogous to that between a "lunatic" and her "conservator," because, like an incompetent, a corporation is incapable of acting at all, other than through its representative, and therefore it is inaccurate to think of the board as an "agent" of the corporation). *See also* HALLIS, *supra* note 70, at 235 (arguing that just as the power of will can be supplied by the guardians of a lunatic or child, the power of will "can be supplied by an individual acting as the organ of the corporate body").

²¹²*See generally* JOSEPH GOLDSTEIN ET AL., *THE BEST INTERESTS OF THE CHILD: THE LEAST DETRIMENTAL ALTERNATIVE* (1996) (discussing the best interest of the child standard as it relates to child custody issues); Jean Koh Peters, *The Roles and Content of Best Interests in Client-Directed Lawyering for Children in Child Protective Proceedings*, 64 *FORDHAM L. REV.* 1505 (1996) (arguing that lawyers need to reconsider their roles when representing children); Carl E. Schneider, *Discretion, Rules and Law: Child Custody and the UMDA's Best-Interest Standard*, 89 *MICH. L. REV.* 2215 (1991) (discussing the recent criticisms of the best interest standard).

²¹³*See* ANN M. HARAMBIE, *THE CHILD'S ATTORNEY* 31 (1993) (discussing very young or abused children).

interests" as viewed by an attorney or judge.²¹⁴ Such guidelines exist because in their absence, the judge or guardian would be forced to choose among various conflicting considerations, such as financial well-being, emotional attachment, racial or cultural affinities, and biological ties. Similarly, lawyers representing inmates on death row may find it difficult to identify their clients' interests when those clients seek to waive available appeals or defenses.²¹⁵ Clients who seek to expedite their executions presumably have an interest in their own deaths.²¹⁶ The lawyers in such cases are forced to choose between acting in accordance with their clients' stated interests and doing what the *lawyers* think is best.²¹⁷ Similar issues face doctors and family members of patients seeking assistance in committing suicide or cessation of life-sustaining treatments. In all these situations, the fiduciaries, and ultimately the courts, are faced with deciding who should speak for the interests of the person in question. Such a determination is based upon established legal doctrines, developed to solve

²¹⁴See GOLDSTEIN, *supra* note 212, at 205-09 (discussing generally the dual role of lawyers when considering both the child's wishes and the child's best interest); HARAMBIE, *supra* note 213, at 31-33 (directing attorneys to assess "reasonableness" of child's wishes); *id.* at 33-35 (addressing situation where "best interests" conflict with "expressed interests").

²¹⁵Gary Gilmore, for example, rejected efforts by his attorneys to appeal his sentence because he wanted to die. See NORMAN MAILER, *THE EXECUTIONER'S SONG* (1979) (describing a fictionalized account of Gilmore's life and death); Martin Kasindorf, *Living on the Brink*, NEWSWEEK, Nov. 29, 1976, at 29 (describing only Gilmore's criminal life and wish for an expedited execution). See also Josephine Ross, *Autonomy Versus a Client's Best Interests: The Defense Lawyer's Dilemma When Mentally Ill Clients Seek to Control Their Defense*, 35 AM. CRIM. L. REV. 1343 (1998) (describing the issues defense lawyers face in deciding to go against the wishes of their clients); Matt Siegel, *Defending a Death Wish*, AM. LAW., Apr. 1993, at 60 (describing convicted killer Thomas Grasso's wish to expedite his death sentence).

²¹⁶See William Booth, *Kaczynski Stands Alone in Resisting Insanity Defense*, WASH. POST, Dec. 26, 1997, at A1 (describing Ted Kaczynski rejected his lawyers' attempts to challenge his mental capacity despite the fact that that seemed to be his only hope for avoiding execution); Kasindorf, *supra* note 215, at 29 (describing death-row inmate Robert White's stated reasons for wanting to die: that he had to pay for his crime, that he was in danger from his enemies, and that he wanted the publicity). See Sandy Banisky, *Kaczynski: A Fool for a Client?*, BALT. SUN, Jan. 8, 1998, at 2A (discussing the ethical issues involved when a defendant refuses to allow his lawyer to argue insanity or mental defect); William Glaberson, *Unabom Trial May Prove Landmark on Illness Plea*, N.Y. TIMES, Dec. 9, 1997, at A18 (speculating that Kaczynski rejected the insanity defense because he feared being labeled mentally ill would undermine his political goals); James Taranto, *Why the Unabomber Must Die*, WALL ST. J., Jan. 6, 1998, at A18 (comparing Kaczynski to convicted killer, inmate, and radio and newspaper commentator Mumia Abu-Jamal).

²¹⁷See James Zirin, *A Slow Explosion in Court*, THE TIMES (London), Jan. 27, 1998, at 37 (discussing the "conflict between a lawyer's duties and a client's rights"); Banisky, *supra* note 216, at 2A (discussing the ethical issues involved when a defendant refuses to allow his lawyer to argue insanity or mental defect).

the problem of identifying the interests of a "person" who cannot articulate his or her own interests.²¹⁸

While the purpose of a business association is usually to advance the business, other purposes may also exist. In some groups, such as social organizations and clubs, the cooperative relationship itself may be the goal.²¹⁹ Similarly, in some partnerships, the cooperative relationship among the partners may be important. Because the partners themselves determine what the purpose of the partnership is, a court examining the act of a partner must consider the agreement among the partners. For example, the presence of a clause in the partnership agreement permitting expulsion without cause may indicate that the purpose of the partnership is not linked to the relationship and identity of the individual partners. Similarly, as in some large professional firms where the partnership is managed by an executive committee with extensive powers,²²⁰ it would be reasonable to conclude that the purpose of that partnership was not to operate with a specific close-knit group of partners, but only to cooperate generally to conduct business.

In other cases, there may be evidence to indicate that the partnership's purpose includes a personal relationship among the partners. Such a case may have existed in *Beasley v. Cadwalader, Wickersham & Taft*.²²¹ There, the firm's partnership agreement contained the following language:

The parties to this Agreement mutually pledge to each other their best efforts to aid each other's professional success and advancement during the continuance of this partnership, so that each party shall receive from the others a fair opportunity to use his best talents and faculties to the common benefit, and shall have an approximate if not complete or perfect

²¹⁸See Stanley S. Herr, *Representation of Clients with Disabilities: Issues of Ethics and Control*, 17 N.Y.U. REV. L. & SOC. CHANGE 609 (1989-1990) (discussing the "proper allocation of responsibilities between lawyer and client" and other issues involved in representing the disabled).

²¹⁹See McDougall, *supra* note 130, at 108 (discussing groups formed for the benefits of group life); Fuller, *supra* note 139, at 3-6 (discussing expulsion from group of "literary snobs"). See also OLSON, *supra* note 132, at 60-63 (describing operation of "social incentives" in groups). In highly cooperative groups expulsion may cause a different sort of harm that should be addressed with a different remedy. See Chafee, *supra* note 75, at 1007 (discussing the disputes of non-profit organizations); VON GIERKE, *supra* note 83, at 206-07 (discussing membership in "personal fellowships").

²²⁰See *Day v. Sidley & Austin*, 394 F. Supp. 986, 991 n.8 (D.D.C. 1975).

²²¹No. CL-94-8646 AJ, 1996 WL 438777 (Fla. Cir. Ct. July 23, 1996), *aff'd*, 1998 WL 904065 (Fla. Dist. Ct. App. Dec. 30, 1998).

compensation for his industry and abilities out of the partnership funds.²²²

That clause may indicate that the purpose of the Cadwalader firm was more than simply making a profit by practicing law, but rather was to foster the development of each partner's legal career, perhaps even at the expense of profit-making.²²³ If so, then a partner's act injuring a single partner's professional prospects or otherwise damaging the relationship among the partners would be counterproductive to the partnership's purpose, even if it enhanced profitability.

D. *Use of the Group Conception of Business Associations to Illuminate Fiduciary Duties*

1. Partnerships

The situation in *Beasley*, in which several partners were expelled to enhance the profit shares of other partners, illustrates the relationship between a partnership's purpose and the acceptable behavior of those acting on its behalf (in this case, the management committee). According to the *Wall Street Journal*, the partners themselves were divided over, or had a change of heart regarding, the purpose of the partnership.²²⁴ Traditionally, Cadwalader was known for its "fusty charm" and for being one of Wall Street's "most humane places to work," a "friendly, homey place."²²⁵ Unfortunately, it was also inefficient and unresponsive to client demands. A group of extremely productive partners, the so-called "Young Turks,"²²⁶ plotted a "cultural revolution" that included the expulsion of unprofitable partners such as Beasley.²²⁷ According to the *Journal*, "[t]he move caused deep pain."²²⁸ In the words of one former partner, the expulsions were "a

²²²Amended Complaint for Dissolution of Partnership, Appointment of a Receiver, Accounting, and Other Relief, and Demand for Jury Trial, Ex. A, at 41-42, *Beasley v. Cadwalader, Wickersham & Taft*, No. CL-94-8646 "AJ," 1996 WL 438777, quoted in Donald J. Weidner, Cadwalader, *RUPA and Fiduciary Duty*, 54 WASH. & LEE L. REV. 877, 887 (1997).

²²³Professor Weidner also notes this possible interpretation of the clause. See Weidner, *supra* note 222, at 887. On the other hand, the quoted language might have been intended to justify a change from lock-step compensation to compensation based on productivity, an interpretation pointed out to me by Professor Barbara Banoff.

²²⁴Paul M. Barrett, *A Once-Stodgy Firm Makes a Flashy Return, But at What Cost?*, WALL ST. J., Aug. 17, 1998, at A1.

²²⁵*Id.*

²²⁶*Beasley*, 1996 WL 438777, at *2.

²²⁷See Barrett, *supra* note 224, at A1.

²²⁸*Id.* at A6.

complete undermining of what had been a very democratic, collegial firm."²²⁹ The co-chair of the firm's management committee, on the other hand, stated that "life is not made up of love, it is made up of fear and greed and money — how much you get paid in large measure."²³⁰ The revamped firm was, however, much more profitable than the old firm had been.²³¹ Thus, *Beasley* can be viewed as involving a group that had lost its consensus about its purpose. As group theory would suggest, the group eventually redefined its purpose by increasing the focus on profitability, resulting with the dissenting or noncomplying members being forced to find another group.

The court in *Beasley* might have considered the implications of group dynamics in determining whether the expelling partners breached their fiduciary duties. Ordinarily, an expulsion does not constitute such a breach,²³² yet the expelled partners may have had a reasonable argument that the management committee's acts were a breach of their duty *to the group* in light of the particular understanding of the cooperative purpose of the Cadwalader partnership. Thus, under *Beasley*, the identification of the purpose of the partnership as a group and of the group's interests in light of its agreement and history, can thus be used to define an act as a breach of fiduciary duty.

2. Corporations

The group conception of the corporation can similarly illuminate the problem of fiduciary duties of controlling shareholders. Controlling shareholders are generally held to owe fiduciary duties, as a result of their controlling position, to other participants in the group. States vary, however, in their answer to the question, to whom do those shareholders owe their duties? Some courts have held that majority shareholders owe duties *directly* to the minority shareholders, with respect to the majority's running of the business as officers and directors and with respect to the majority's exercise of its rights as a shareholder.²³³ For example, a long line of cases in Massachusetts holds that the fiduciary duties owed by shareholders in close corporations extend to protecting the other shareholders' expectations that they will be employed by the corporation and receive certain economic

²²⁹*Id.*

²³⁰*Beasley*, 1996 WL 438777, at *7.

²³¹See Barrett, *supra* note 224, at A1.

²³²See Dalley, *supra* note 6, at 188-90. The trial court in *Beasley* found that a breach of fiduciary duty had occurred because the partnership agreement did not contain a clause permitting expulsion. See *Beasley*, 1996 WL 438777, at *6; Dalley, *supra* note 6, at 208.

²³³Under Delaware law, a majority shareholder is entitled to act self-interestedly in voting her shares. See *Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 444 (Del. 1996).

benefits from their investment, even when those expectations are not protected by law or contract.²³⁴

The group conception of the corporation would support both the Delaware and Massachusetts rules, depending upon the circumstances of each case.²³⁵ To the extent the corporate purpose was the traditional "pooling of capital to invest in a business," the Delaware position, that the majority shareholder, like officers and directors, owes duties only to the corporation (or group), is most consistent with the purpose of the group. If, on the other hand, the purpose of the group is "to band together to run a business together," then the Massachusetts rule, that the controlling shareholder (and the officers and directors) owe duties to the other shareholders is also consistent with the group's identity. The inquiry, however, must be a fact specific one, as in the partnership context described above.

The group conception can also shed light on the specific issue of the sale of a controlling block of stock by a shareholder. Generally, a shareholder who receives a control premium²³⁶ in the sale of her stock is not required to share the premium with the other shareholders.²³⁷ However, in *Jones v. H.F. Ahmanson & Co.*,²³⁸ a strange but widely-cited California case, the majority shareholder was forced to share its control premium with the minority shareholder. H.F. Ahmanson & Co., with others, was the controlling shareholder in United Savings and Loan Association of California (USLAC). The stock of USLAC was not widely traded because

²³⁴See *Merola v. Exergen Corp.*, 668 N.E.2d 351 (Mass. 1996) (holding that claim for breach of fiduciary duty lay only against majority shareholder and not the corporation itself); *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1976) (indicating that the court must analyze the action taken by the controlling stockholders in each individual case to determine if such action serves a legitimate business purpose); *Donahue v. Rodd Electrotypes Co.*, 328 N.E.2d 505 (Mass. 1975) (comparing the fiduciary duties stockholders in close corporations owe each other to the duties partners owe each other).

²³⁵For an illustration of the way in which the court's view of the facts of the case influences its decision, compare *Nixon v. Blackwell*, 626 A.2d 1366 (Del. 1993) (noting that position of minority shareholders was part of corporate structure deliberately established by founder), with *Donahue*, 328 N.E.2d at 514-15 (treating minority shareholder's position as apparently unanticipated).

²³⁶A "control premium" is the amount paid for a controlling block of stock that exceeds the per-share price of the stock. The premium represents the advantages of controlling an enterprise over merely sharing in its ownership.

²³⁷See *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 408 (Del. 1985) (stating that, so long as they act in good faith, corporate directors are free to dispose of their shares any way they see fit); *Zetlin v. Hanson Holdings, Inc.*, 397 N.E.2d 387, 388 (N.Y. 1979) (holding that a shareholder is free to sue a controlling interest share in a corporation at a premium price). *But see* *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir. 1955) (ruling, in effect, that the sale of control of a steel company during the Korean War was an appropriation of the corporate opportunity to profit from the war).

²³⁸460 P.2d 464 (Cal. 1969).

there were relatively few shares outstanding, the per-share price of the stock was very high, and the company did not publish extensive financial information.²³⁹ When savings and loan stocks became popular in the late 1950s, Ahmanson created a market for its shares in USLAC by creating a new corporation, United Financial Corporation of California (UFC), transferring its USLAC shares to UFC (thus making UFC a holding company for most of the outstanding USLAC stock) and offering UFC shares to the public.²⁴⁰ The minority shareholders in USLAC were not offered the opportunity to participate in this scheme at the outset,²⁴¹ and their shares remained relatively unmarketable.²⁴² The court ruled that Ahmanson's conduct violated its fiduciary duties to the minority shareholders of USLAC.²⁴³

The court rejected the "early" rule that majority shareholders have the "perfect right to dispose of their stock . . . without the slightest regard to the wishes and desires or knowledge of the minority stockholders," and that fiduciary duties were owed only to the corporation.²⁴⁴ Rather, a standard of "inherent fairness from the viewpoint of the corporation and those interested therein" applied to "transactions wherein controlling shareholders seek to gain an advantage in the sale or transfer or use of their controlling block of shares."²⁴⁵ Thus, "[a]ny use to which they [majority shareholders] put the corporation or their power to control the corporation must benefit all shareholders proportionately."²⁴⁶

The group conception of the corporation reveals the problem with the *Ahmanson* decision. Each member of the group joins the group for the specified purpose, but she does not thereby abrogate her status as an individual or as a member of other groups. She also does not subordinate her separate interests to the separate interests of the other members. Different groups have different rules about a member's power to leave the group: partners ordinarily may not freely transfer their interests,²⁴⁷ although

²³⁹*See id.* at 466.

²⁴⁰*See id.* at 467-68.

²⁴¹UFC did occasionally offer to buy USLAC shares from minority holders at a price below the book value per share. *See id.* at 468-69.

²⁴²*See Ahmanson*, 460 P.2d at 469.

²⁴³*See id.* at 476.

²⁴⁴*Id.* at 472 (quoting *Ryder v. Bamberger*, 158 P. 753, 759 (Cal. 1916)).

²⁴⁵*Id.* at 472-73 (quoting *Remillard Brick Co. v. Remillard-Dandini Co.*, 241 P.2d 66, 75 (Cal. App. 1952)).

²⁴⁶*Ahmanson*, 460 P.2d at 471. This statement would be perfectly consistent with the usual rule if "power to control the corporation" were read to mean only acts the majority holder performs on behalf of the corporation, and not acts taken on its own behalf, such as voting or selling its shares.

²⁴⁷*See* UPA §§ 18(g), 27; RUPA §§ 401(i), 502.

corporate shareholders usually may. *Ahmanson* effectively requires a member of the group to base decisions about his or her separate interests upon the separate interests of the other members of the group as individuals. This rule is the theoretical equivalent of requiring one member of a group to invest in a retail business, contrary to her own interests, to advance the interests of another member's manufacturing operations. In short, the rule treats the corporation as a collection of individuals bound together in every facet of their lives and ignores the nature of the corporation as a purposive group whose purpose, in this case, was to conduct a savings and loan.

3. Limited Liability Companies

The utility of the group conception of the business association can also be seen in an analysis of a recent Delaware case involving an LLC. In *VGS, Inc. v. Castiel*,²⁴⁸ Castiel controlled seventy-five percent of the LLC through two wholly owned corporations and had the contractual right to appoint two of the three members of the LLC's board of managers.²⁴⁹ Sahagen, the other member, had the right to appoint the third member of the board. Castiel appointed himself and Quinn, while Sahagen appointed himself.²⁵⁰ Disputes arose in the management of the LLC, and most of the testimony indicated that Castiel's management was damaging the interests of the LLC.²⁵¹ Even Quinn, Castiel's nominee to the board, turned against Castiel and conspired with Sahagen to cause a merger of the LLC with a newly formed corporation, thereby terminating Castiel's control of the business.²⁵² Then-Vice Chancellor Steele agreed that Quinn and Sahagen had the legal right to force a merger, under the Delaware Limited Liability Company Act²⁵³ and their agreement.²⁵⁴ Nevertheless, Quinn's and Sahagen's actions had violated their duty of loyalty to Castiel.²⁵⁵

The group conception of the LLC indicates a contrary result in this case. The Uniform LLC Act provides that managers owe fiduciary duties to the LLC and the members,²⁵⁶ but they owe their duty to the *group* of members, not to the members individually.²⁵⁷ If the LLC as a whole (in

²⁴⁸No. 17,995, 2000 Del. Ch. LEXIS 122, at *1 (Aug. 31, 2000).

²⁴⁹*Id.* at *4.

²⁵⁰*Id.*

²⁵¹*Id.* at *4-5.

²⁵²*VGS, Inc.*, 2000 Del. Ch. LEXIS 122, at *5-6.

²⁵³DEL. CODE ANN. tit. 6, § 18-1001 (1999).

²⁵⁴*VGS, Inc.*, 2000 Del. Ch. LEXIS 122, at *7-10.

²⁵⁵*See id.* at *10-14.

²⁵⁶*See* ULLCA § 409.

²⁵⁷This is true even if one treats the LLC as the functional equivalent of a partnership. *Id.*

other words, the group) benefitted from the acts of Sahagen and Quinn, the fact that one member's individual interests were adversely affected should be irrelevant. Then-Vice Chancellor Steele's ruling, which would require Quinn and Sahagen to act to protect Castiel's separate interests at the expense of the interests of the business as a group,²⁵⁸ directly conflicts with the group conception of the business association.

V. CONCLUSION

The theoretical literature provides a coherent basis for our understanding of the nature of business associations. First, they are conceptually separate bodies with their own interests, and, while identification of those interests can present challenges, the process of interest identification is a familiar one. Some person(s) or group is identified by agreement or by law as the "organ" of the group. The organ is charged with identifying the group's interests, subject to certain limitations. Because the association is identified by its purpose and its cooperative nature, its interests must be both to advance its purpose and to preserve its cooperative nature. The latter interest is served by choosing courses of action that minimize conflict, by fostering the development of and enforcing appropriate norms of behavior, and adopting procedures, such as elections and regular meetings, to identify and enhance consensus. The extent and nature of the cooperation essential to the association will vary among the groups. The association's purpose will be determined first by reference to its founding and then by reference to subsequent events, including the expressed will of the members of the group.

In a corporation, the law conveniently provides that the board of directors speaks for the corporation. The board must decide what to say, based on the multiple interests of the corporation; this is the genesis of the Berle-Dodd debate and the "other constituency" controversy.²⁵⁹ The group

²⁵⁸There is some indication that the vice chancellor thought it was appropriate for Quinn to consider his obligations to Castiel, as the member who had appointed him to the board, in acting as a member of the board. See *VGS, Inc.*, 2000 Del. Ch. LEXIS 122, at *6 (stating that "[h]ad he known in advance, Castiel surely would have attempted to replace Quinn with someone loyal to Castiel who would agree with his views"). While this might be true as a matter of agency law, it is quite clear under Delaware corporate law that a director owes her loyalty to the corporation, not to the shareholder who elected her. The vice chancellor later acknowledges this when he refers to Quinn as the "allegedly disinterested and independent member." See *VGS, Inc.*, 2000 Del. Ch. LEXIS 122, at *16.

²⁵⁹See James S. Coleman, *Responsibility in Corporate Action: A Sociologist's View*, in *CORPORATE GOVERNANCE AND DIRECTORS' LIABILITIES: LEGAL, ECONOMIC, AND SOCIOLOGICAL ANALYSIS ON CORPORATE SOCIAL RESPONSIBILITY* 69, 79-82 (Klaus J. Hopt & Gunther Teubner eds., 1984) (describing role of board in determining corporation's interests). See also *supra* note 40 and accompanying text.

comprises only the shareholders, but its interests are not those of the shareholders in their individual capacities. Rather, the group is the shareholders brought together to achieve a common purpose, which is to operate a successful business. The interests of the group, therefore, are the interests of the business, and it is the business that the corporate organ must seek to advance and protect. Corporate fiduciary duty principles generally reflect this understanding, despite the controversy among commentators about the nature of the entity and the existence of "other constituencies." As a general matter, the law presumes that the managers, as the "organ," are acting in the interests of the business, because defining those interests is the role of the organ. When there is reason to doubt that presumption, as where, for example, the procedures for making decisions have not been followed or the managers have personal interests that are adverse to those of the group, a court will inquire further into whether the action was, in fact, in the interests of the group.

In a partnership, where each partner has full management rights,²⁶⁰ any partner may, presumably, speak for the partnership and identify the partnership's interests. That power is limited in the same way the corporate organ is limited: by authority principles²⁶¹ and by the fiduciary duties the partner owes to the partnership. Furthermore, case law provides that a partner's management power is limited to the original understanding of the partners or a later modification thereof agreed to by a majority of the partners.²⁶² Thus, the partnership's interests are identified by the organ of the partnership, the partners, subject to the limitations placed on their authority by partnership law. Each partner owes duties to the distinct group, defined by reference to its business purpose, and must seek to advance the interests of the group as articulated by any partner within the scope of her authority.

RUPA's change from an aggregate conception of the partnership to an entity effectuated certain technical legal changes. As a legal person, a partnership can sue, be sued, and own property in its own name, all of which are activities that will make life easier for partners and their lawyers. But the nature of the partnership has not changed. The partnership as an entity is,

²⁶⁰See UPA §§ 9(1), 18(e); RUPA §§ 301(1), 401(f). The same argument would apply to a member-managed LLC. See ULLCA § 404.

²⁶¹See UPA § 9 (authorizing acts "for apparently carrying on in the usual way the business of the partnership"); RUPA § 301 (authorizing acts "for apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership").

²⁶²See BROMBERG & RIBSTEIN, *supra* note 4, § 4.02(a)(3) (describing scope of partner's authority); *id.* § 5.03(c)(1) (discussing management power with respect to new and existing courses of action). See also *Shawn v. England*, 570 P.2d 628 (Okla. App. 1977) (holding that business that evolved from the marketing of a "thunder lizard" doll to the printing and sale of a book on Oklahoma weather was conducted by one partnership despite the change in business, based on the behavior of the partners).

as it has always been, a cooperative relationship among individuals for a specific business purpose. Each individual owes duties to the group of individuals (or, for the sake of convenience, to the "partnership") not to engage in behavior that harms the group (defined, as always, with respect to the business). This conception of the partnership comports not only with the common law and the law under the UPA, but also with a broader understanding of the way humans think and behave. Even unsophisticated partners understand that they are entering into a relationship for a specific purpose, and that to further their individual interests at the expense of the group is wrong, when the matter in question relates to the business of the partnership. But a lawyer ordinarily has no duty to share a real estate opportunity with his partners, and an accountant ordinarily does not expect to be sued for breach of duty if she jumps ahead of one of her partners in the queue for season tickets to the Green Bay Packers games.

There is nothing earth-shattering here; it is a concept most nonlawyer partners could easily explain. Unfortunately, the debate over legal personality, the use of the aggregate/entity vocabulary and the rather strident debate over "other constituencies" in corporate law has obscured a rather simple but fundamental concept. That concept can help jurists think more clearly about business associations, in particular about fiduciary duties, and help the law to achieve its goal in this area, which is to allow individuals to form stable relationships in which they pursue an agreed-upon purpose and engage in a successful business enterprise.

