The Misguided Transformation of Loyalty into Contract

Reza Dibadj
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I. INTRODUCTION

In a fiduciary relationship, the fiduciary is entrusted with discretion over the beneficiary’s assets. The relationship is a variation on the perennial principal-agent problem. The fiduciary is an agent of the beneficiary and “within the scope of the relationship, the fiduciary is to act in a disinterested manner in the beneficiary’s best interests.” Given the simple reality that “dependency or vulnerability of the beneficiary is a classic component of any fiduciary relation” and the “unavoidable fact that the interests of the principal and the fiduciary are not perfectly aligned,” fiduciary law has evolved to protect the beneficiary from possible abuses of the relationship by the fiduciary.

The central problem in a fiduciary relationship is the potential “abuse of delegated power.” More specifically, the risk is that the fiduciary—to whom discretion is entrusted—might place its interests above those of the beneficiary. To try to protect

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4. See e.g. Dickerson, supra n. 2, at 116. For a discussion of some theoretical nuances embedded in fiduciary law, see William W. Bratton, Self-Regulation, Normative Choice, and the Structure of Corporate Fiduciary Law, 61 Geo. Wash. L. Rev. 1084 (1993). In particular, Bratton asserts that “[f]iduciary relationships present a problem of legal classification. They lie in a gray area between the more clearly defined worlds of government regulation and private ordering through contract.” Id. at 1100.


6. E.g. id. at 808–09 (“A central feature of fiduciary relations is that the fiduciary serves as a substitute for the entrustor. . . . The power that the fiduciary obtains is originally vested in someone else, and is delegated to the fiduciary not for his own use, but solely for the purpose of facilitating the performance of his functions.”).

7. Id. at 809 (“[W]hile the fiduciary must be entrusted with power in order to perform his function, his possession of the power creates a risk that he will misuse it and injure the entrustor.”); D. Gordon Smith, The Critical Resource Theory of Fiduciary Duty, 55 Vand. L. Rev. 1399, 1497 (2002) (“Simply stated, the role of fiduciary duty is to curb such self-interested behavior in the absence of complete specification of the fiduciary’s obligations.”).
against this risk, the duty of loyalty—which requires that the agent place the principal’s interest ahead of its own—has historically been the most prominent fiduciary duty. As one commentator sums up: “[F]iduciary relationships form when one party (the ‘fiduciary’) acts on behalf of another party (the ‘beneficiary’) while exercising discretion with respect to a critical resource belonging to the beneficiary. . . . [T]he duty of loyalty that is the essence of fiduciary duty protects beneficiaries against opportunistic behavior by fiduciaries.”

Unfortunately, the law of unincorporated associations is engaged in a misguided march: it is transforming the duty of loyalty into a contractarian construct. This article argues that these developments reflect doctrinal confusion, outworn economics, and weak policy. If anything, the duty of loyalty needs to be strengthened, not watered down.

Part II traces the evolution of the duty of loyalty in the law of unincorporated associations. It begins with a discussion of the struggle between contractarianism and fiduciary duty in the uniform laws promulgated by the National Conference of Commissioners on Uniform State Laws in the realm of partnerships, limited partnerships (“LP”), limited liability partnerships (“LLP”), and limited liability companies (“LLC”). It then shifts gears to the more squarely contractarian, and likely highly influential, Delaware statutes covering the same business entities. The current state of the doctrine suggests that precious little is left of the duty of loyalty. The law of unincorporated businesses increasingly represents a series of default provisions in statutes that private parties are free to contract around, unrestricted even by ex post judicial review through the concept of fiduciary duty.

Part III argues that this has been a misguided transformation along three dimensions. First, the move conflates fiduciary with contractual duties—notably, in trying to replace an established duty of loyalty with weak and nebulous notions of good faith. Second, it deploys outworn economic concepts reminiscent of the neoclassical Chicago School. The economic justifications for contractarianism are based on facile assumptions applied in a static manner; they do not represent real humans interacting in real institutions over time. Third, the move from loyalty to contract brings with it a host of public policy problems: it tries to toss out a well-developed legal tradition, it downplays the role of trust and morality, and it ignores the role positive law can play in shaping norms. In the end, the rise of contractarianism reflects a step backward to nineteenth-century legal formalism and presents the risk that its faulty precepts may spread further into corporate law.

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8. For instance, in corporate law “the duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally.” Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993).

9. Cf. Dickerson, supra n. 2, at 118 (“[O]nly the duty of loyalty is undeniably a fiduciary duty, presumably because it automatically satisfies the historical definition of fiduciary duty.”). The other major duty typically conceptualized as a fiduciary one is, of course, the duty of care. See e.g. ALI Principles of Corp. Governance § 4.01 (1992).

10. Smith, supra n. 7, at 1402 (emphasis in original, footnote omitted).
II. FROM LOYALTY TO CONTRACT

A. Uniform Laws

The past two decades have seen a spectacular proliferation of unincorporated associations. In addition to general partnerships, there has emerged a veritable “alphabet soup” of entities: LPs, LLPs, LLCs, and even limited liability limited partnerships. The emergence of these entities has been accompanied by the promulgation of several uniform laws. Partnership law, stable since the development of the Uniform Partnership Act (“UPA”) in 1914, witnessed the introduction of the Revised Uniform Partnership Act (“RUPA”) starting in 1992. For their part, LPs have been provided statutory guidance through the Uniform Limited Partnership Act (“ULPA”) beginning in 1916, which was superseded by the Revised Uniform Limited Partnership Act (“RULPA”) in 1976, as amended in 1985, and the Uniform Limited Partnership Act of 2001 (“ULPA 2001”). Finally, the Uniform Limited Liability Company Act (“ULLCA”), promulgated in 1996, guides LLCs.

Before analyzing why the march toward contractarianism is misguided, I will briefly highlight the evolution of the uniform laws’ position on the duty of loyalty. Historically, UPA was essentially silent on fiduciary duties, referring instead to the law of agency. Given the sparseness of the statute, courts fashioned the duty of loyalty as a matter of common law.

ULPA, however, is an entirely different story. It narrows “[a] partner’s duty of loyalty to the partnership and the other partners” to three items:

1. to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived

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11. For an overview of these different entities, see Carter G. Bishop, Unincorporated Limited Liability Business Organizations: Limited Liability Companies and Partnerships, 29 Suffolk U. L. Rev. 985, 993–1004 (1995). The limited liability limited partnership is perhaps the least known among these entities. In a nutshell, it permits an LP to “eliminate the vicarious liability of general partners and, in some cases, of limited partners who participate in management.” Larry E. Ribstein, The Evolving Partnership, 26 J. Corp. L. 819, 839 (2001).

12. LLPs are typically governed through addenda included in the partnership statute. See e.g. RUPA §§ 1001–1003, 6 U.L.A. 1 (2001); John H. Matheson & Brent A. Olson, A Call for a Unified Business Organization Law, 65 Geo. Wash. L. Rev. 1, 19 (1996) (“An LLP is a general partnership that is subject to usually a one paragraph statutory provision restricting its liability if appropriate documentation is filed with a state.”).

13. The most directly relevant provision is UPA § 21, entitled “Partner Accountable as a Fiduciary,” and stating in relevant part only that

[e]very partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.


14. The UPA stated: “The law of agency shall apply under this act.” Id. at § 4(3). For a discussion of the incomplete mapping of the law of agency to the duty of loyalty, see infra n. 115.

15. See e.g. Dickerson, supra n. 2, at 114 (noting that UPA’s “wording specifically creates only the duty of a partner to account for his or her profits derived directly from the partner’s relationship with the partnership or its assets. Nevertheless, the courts have extracted broad-based fiduciary duties, including particularly a duty of loyalty, from that narrow language.” (footnotes omitted)).

16. RUPA § 404(b).
from a use by the partner of partnership property, including the appropriation of a partnership opportunity;

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

(3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership. 17

RUPA further provides that although the duty of loyalty cannot be eliminated, it may be waived by agreement or upon disclosure and approval:

(i) the partnership agreement may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable; or

(ii) all of the partners or a number or percentage specified in the partnership agreement may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty. 18

Perhaps to try to show that it is compensating for its frugal view of loyalty, RUPA does impose a good faith obligation on partners. 19 Like loyalty, this duty cannot be eliminated entirely, but once again “the partnership agreement may prescribe the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable.” 20 Finally, RUPA boldly declares that “[a] partner does not violate a duty or obligation under [RUPA] or under the partnership agreement merely because the partner’s conduct furthers the partner’s own interest.” 21

The shift in approach from UPA to RUPA is nothing short of spectacular. As one scholar has observed, RUPA “flatly rejects the existing collective loyalty concept . . . . This shift is breathtaking. In one stroke of the pen the drafters have made the partners adversaries.” 22 Unfortunately, other uniform laws pertaining to unincorporated associations have copied RUPA nearly verbatim.

In the world of LPs, ULPA and RULPA simply noted that the law of partnership applied to the general partner. 23 Thus, a general partner in a UPA jurisdiction would

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17. Id.; see Allan W. Vestal, Fundamental Contractarian Error in the Revised Uniform Partnership Act of 1992, 73 B.U. L. Rev. 523, 533 (1993). The duty of loyalty is also limited temporally. See e.g. RUPA § 603(b)(3) ("[T]he partner’s duty of loyalty . . . . continue[s] only with regard to matters arising and events occurring before the partner’s dissociation, unless the partner participates in winding up the partnership’s business.").

18. RUPA § 103(b)(3).

19. Id. at § 404(d) ("A partner shall discharge the duties to the partnership and the other partners under this [Act] or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing." (bracket in original)).

20. Id. at § 103(b)(5) (emphasis added).

21. Id. at § 404(c) (bracket in original).


23. RULPA § 403(a), 6A U.L.A. 125 (2003) ("Except as provided in this [Act] or in the partnership agreement, a general partner of a limited partnership has the rights and powers and is subject to the restrictions of a partner in a partnership without limited partners." (bracket in original)). By contrast, as one might expect, “[a] limited partner does not have any fiduciary duty to the limited partnership or to any other partner solely by reason of being a limited partner.” ULPA 2001 § 305(a), 6A U.L.A. 1 (2003); see also id. at cmt. subsec. (a)
likely have greater fiduciary obligations than one in a RUPA jurisdiction. ULPA 2001, however, is a self-contained statute that must, therefore, express a vision of fiduciary duties. Its pattern precisely mimics RUPA: cabin loyalty to the same three items as in RUPA, allowing waivers of loyalty by agreement as long as they are "not manifestly unreasonable," imposing a duty of good faith that the partners may define provided their standards are "not manifestly unreasonable," and declaring that a partner can pursue his own interest without violating any fiduciary obligations. Put succinctly, ULPA 2001 "eschews the UPA's open-ended approach to general partner fiduciary duties and incorporates essentially verbatim RUPA's provision on fiduciary duty and the obligation of good faith and fair dealing."

Unsurprisingly, ULLCA follows RUPA as well. The duty of loyalty of LLC members extends only to the now familiar three items that can be waived as long as the waiver is "not manifestly unreasonable." The duty of good faith can also be defined by the parties as long as their standards are "not manifestly unreasonable." And, of course, ULLCA provides that "[a] member of a member-managed company does not violate a duty or obligation under [ULLCA] or under the operating agreement merely because the member's conduct furthers the member's own interest." As the old saying goes, it is déjà vu all over again.

Two patterns emerge from this brief survey of the new uniform laws: RUPA, ULPA 2001, and ULLCA. The first, and most obvious, is a sharp departure away from fiduciary duties toward contractarianism. As one commentator summarizes in the context of RUPA:

Essentially, this new language permits the parties to enter into a valid, enforceable agreement that would remove, prospectively, virtually any duty of loyalty. The agreement would be valid as long as it does not violate [an] attenuated obligation of good faith and fair dealing; describes categories of permitted activities; and as long as it is not otherwise manifestly unreasonable. The burden of proving a violation has shifted to the complaining

("Under this Act, limited partners have very limited power of any sort in the regular activities of the limited partnership and no power whatsoever justifying the imposition of fiduciary duties to the limited partnership or fellow partners.")

25. ULPA 2001 § 408(b).
26. Id. at § 110(b)(5)(A).
27. Id. at § 408(d).
28. Id. at § 110(b)(7).
29. Id. at § 408(e).
32. Id. at § 103(b)(2)(i).
33. Id. at § 409(d).
34. Id. at § 103(b)(4).
35. Id. at § 409(e).
party who must prove that a stipulated category is “manifestly unreasonable.” Are we really much beyond a mere requirement of good faith?\(^{36}\)

The second, somewhat subtler pattern is the remaining struggle to maintain some notion of fiduciary duty in statutes otherwise beset by contractarianism.\(^{37}\) While some critics contend that the mention of any residual fiduciary obligations is merely a façade,\(^{38}\) contractarians believe that the uniform laws have still not gone far enough.\(^{39}\) Notwithstanding this residual and contradictory impulse, it is amply clear that the uniform laws of unincorporated associations have been moving away from “traditional standards and substituting fiduciary duties with a narrower scope and less demanding substance.”\(^{40}\)

B. Delaware’s Approach

Delaware—already having won the race for incorporations\(^{41}\)—does not suffer from even a trace of ambivalence, especially after its laws were amended in 2004. The Delaware Revised Uniform Partnership Act (“DRUPA”) declares boldly that “[i]t is the policy of [DRUPA] to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements,”\(^{42}\) while freeing itself of any vestiges of the common law.\(^{43}\) It then provides:

A partnership agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a partner or other person to a partnership or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement; provided, that a partnership agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.\(^{44}\)

In other words, the duty of loyalty may simply be waived; instead, the duty of good faith

\(^{36}\) Dickerson, supra n. 2, at 146-47.

\(^{37}\) See e.g. ULLCA § 103 cmt. (“To the extent not otherwise mentioned in subsection (b), every section of this Act is simply a default rule, regardless of whether the language of the section appears to be otherwise mandatory. . . . Under subsections (b)(2) to (4), an irreducible core of fiduciary responsibilities survive any contrary provision in the operating agreement.”); see also Sandra K. Miller, What Standards of Conduct Should Apply to Members and Managers of Limited Liability Companies? 68 St. John’s L. Rev. 21, 65 (1994).

\(^{38}\) E.g. Vestal, supra n. 17, at 551 (“Having adopted the contractarian premise, however wrong it might be, the statute is misleading in giving the appearance of being faithful to the fiduciary-based history of partnership law. In reality, the proposal is a radical departure from existing law and it should be labeled as such.” (footnotes omitted)).

\(^{39}\) E.g. Ribstein, supra n. 24, at 962 (“The main problem with RUPA/ULPA 2001 lies in their restrictions on waiver.” (footnote omitted)).

\(^{40}\) Smith, supra n. 7, at 1485 (footnote omitted); see also Claire Moore Dickerson, Equilibrium Destabilized: Fiduciary Duties Under the Uniform Limited Liability Company Act, 25 Stetson L. Rev. 417, 448 (1995); Allan W. Vestal, “Assume a Rather Large Boat . . .” : The Mess We Have Made of Partnership Law, 54 Wash. & Lee L. Rev. 487, 531–32 (1997) (“[T]he well-established outlines show us a range of fiduciary duties that starts out as statutory and exclusive, restrictively defined and temporarily limited, and is then broadly amendable. The precise range of options to which the partners may bargain is not well settled, but the power is certainly broad.” (footnotes omitted)).

\(^{41}\) See Reza Dibadj, Delaying Corporate Law, 34 Hofstra L. Rev. 469 (2005).


\(^{43}\) Id. at § 15-1201 (“The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this chapter.”).

\(^{44}\) Id. at § 15-103(f).
is introduced. The Delaware Revised Uniform Limited Partnership Act ("DRULPA") proceeds in analogous fashion. It states that freedom of contract shall govern,45 frees itself from the common law,46 and provides that the duty of loyalty can simply be waived.47 As in DRUPA, a non-waivable duty of good faith is simultaneously introduced.48 Predictably, the Delaware Limited Liability Company Act ("DLLCA") follows exactly the same three steps: extolling freedom of contract,49 untethering the statute from the common law,50 and allowing loyalty but not good faith to be waived.51

Of course, Delaware’s approach is not the only one, and the proliferation of new unincorporated associations52 is accompanied by vast differences in statutory approaches among states in their regulation of each of these entities.53 Commentators have lamented the "increasingly vast and disjointed realm so cumbersome and abstruse as to confound all but the most die-hard business law scholars and practitioners."54 An additional piece to the puzzle, however, should fuel convergence. Given that unincorporated businesses, like corporations, can choose what state law will govern their "internal affairs," a race is likely to develop among states to attract filings of unincorporated associations.55 If the history of corporate law is any indication, Delaware is likely to win this race by loosening mandatory restrictions on businesses created under its laws.56 Indeed, this is precisely the approach that DRUPA, DRULPA, and DLLCA have taken.

As a consequence, the unabashed contractarianism of the Delaware statute—rather than the more guarded contractarianism of the uniform laws—is likely to emerge as the de facto "national" law of unincorporated associations. Contractarians, much to their
delight, point out that “the combination of the Delaware statute and the expansion of enforcement of contractual choice of law suggests that truly mandatory fiduciary duties are virtually a dead issue.” 57 Unfortunately, transforming mandatory fiduciary duties into a “dead issue” is a bad idea. 58

III. A MISGUIDED TRANSFORMATION

The transformation from loyalty to contract has been misguided along three dimensions. It muddles doctrine, espouses antiquated economics, and reflects poor public policy.

A. Doctrinal Confusion

Fiduciary duties and contracts are two different things. While a more nuanced contract theory may represent an improvement over the current legal regime, it too is left wanting.

1. Transposing Contract

The transformation of loyalty into contract exhibits doctrinal confusion when it equates partnerships to contracts. Larry Ribstein, a leading and eloquent contractarian voice, argues that “because partnerships, like other business associations, clearly are voluntary relationships, contracts inevitably will hold sway.” 59 Ribstein then proceeds to argue that “[f]iduciary duties are a type of contract term that applies, in the absence of a contrary agreement, where an ‘owner’ who controls and derives the residual benefit from property delegates open-ended management power over property to a ‘manager.’” 60

Unfortunately, transforming fiduciary obligations into waivable contractual terms is simply inconsistent with a long-standing understanding of what fiduciary duties are. Fiduciary law is different than contract law along several crucial dimensions. As Tamar Frankel outlines:

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57. Larry E. Ribstein, Fiduciary Duty Contracts in Unincorporated Firms, 54 Wash. & Lee L. Rev. 537, 589 (1997) (footnote omitted); cf. Vestal, supra n. 55, at 271 (“It would be a hollow victory indeed for a state to prevail on the underlying policy question, adopting a fiduciary-based partnership law, only to have partnerships use the less prominent amendment and choice of law provisions to evade the fiduciary rules.”).

58. Interestingly, mandatory limited liability seems to suit the contractarians just fine. Cf. Douglas M. Branson, The Death of Contractarianism and the Vindication of Structure and Authority in Corporate Governance and Corporate Law, in Progressive Corporate Law, supra n. 56, at 93, 93 ("One mandatory feature of the legal landscape the contractarians would retain is the limited liability of corporations." (footnote omitted)).

59. Ribstein, supra n. 11, at 848; see also id. at 822. This argument is analogous to the one contractarians have made in the corporate context. See e.g. William W. Bratton, Game Theory and the Restoration of Honor to Corporate Law’s Duty of Loyalty, in Progressive Corporate Law, supra n. 56, at 139, 149 (“The contract paradigm asserts that corporations are constituted entirely of contracts resulting from the voluntary and purposeful interaction of rational actors in a competitive environment.”). For a discussion of why the corporation cannot be analyzed simply as contract, see Reza Dibadj, Reconceiving the Firm, 26 Cardozo L. Rev. 1459 (2005).

First, because fiduciary law is aimed at reducing the entrustors' risks, the law regulates mostly the fiduciaries. Contract law regulates both parties equally.

Second, although most types of fiduciary relationships are grounded in the consent of both parties, fiduciary law is triggered primarily by the consent of the fiduciary to serve. . . . Contracts require, in all cases, the consent of all parties.

Third, fiduciary law is easily applicable because entry into fiduciary relationships involves low costs, requiring no formalities or special conditions. These requisites are far less formal than the requisites for contract.

Fourth, because fiduciary law addresses the entrustors' risks from relationships, the rules dictate how fiduciaries should behave. Contract rules are far less intrusive.

Fifth, because entrustors' risks from the relationship vary, fiduciary rules that address these risks vary more than contract rules.

Sixth, the focus on the entrustor's potential harm from the relationship explains the ascendancy of fiduciary rules over other legal arrangements. Because the private arrangements and other rules that govern the relationships are not deemed sufficient to protect entrustors, fiduciary law is superimposed on the other rules. 61

As Frankel summarizes, "[t]he main difference between the two systems revolves around the right of one party to rely on the other. Entrustors are entitled to rely on their fiduciaries to a greater extent than contracting parties are entitled to rely on each other." 62 The difference is stark—"In the world of contract, self-interest is the norm, and restraint must be imposed by others. In contrast, the altruistic posture of fiduciary law requires that once an individual undertakes to act as a fiduciary, he should act to further the interests of another in preference to his own." 63 It follows that "[o]nce a relation is established, . . . its classification as fiduciary and its legal consequences are primarily determined by the law rather than the parties." 64 Indeed, "[a]rguably, the very request by a fiduciary for waiver of his duties could constitute a violation of these duties." 65

Given these substantial differences, it is a testimony to the power of contractarian rhetoric that its supporters have been able to muddy the boundary between fiduciary law and contract law. 66 Contractarians have additionally been brilliant in their ability to anticipate potential fears that might emerge as a consequence of their anemic conception of loyalty. Their addition of the duty of "good faith and fair dealing" to the doctrine of unincorporated associations is another rhetorical masterstroke. 67 Unfortunately, good

62. Id. at 1276; see also id. at 1223.
63. Frankel, supra n. 5, at 830.
64. Id. at 820.
65. Frankel, supra n. 61, at 1230.
66. Cf. Vestal, supra n. 17, at 550 ("The initial question is whether the duty of loyalty set forth in the Revised Act should be labeled 'fiduciary' at all." (footnote omitted)). A similar linguistic feat occurred when the Chicago School masterfully redefined "consumer welfare" in antitrust law to mean overall allocative efficiency. See Reza Dibadj, Saving Antitrust, 75 U. Colo. L. Rev. 745, 749–55 (2004).
67. See supra pt. II; see also Ribstein, supra n. 57, at 594 ("[T]he parties should be able to alter default
faith—to the extent it can even be defined meaningfully—is a different concept from loyalty.

To begin with, “good faith and fair dealing” is a contractual term designed for relationships characterized by self-interest, not dependency. The comments to the uniform laws themselves plainly state that good faith is not a fiduciary obligation,\(^6\) rather, it is derived from the Uniform Commercial Code.\(^6\) As one commentator points out, there are myriad differences between fiduciary obligations and good faith:

[The] primary differences between fiduciary duties and the standard of good faith and fair dealing turn upon the ability to act in a self-interested manner, the computation of damages, the presumption that the parties operate on an equal footing, and the presence or absence of an imperative further to the beneficiary’s interests.\(^7\)

Moreover, Frankel observes,

[i]n no sense are fiduciary relations and the risks they create for the entrustor similar to adhesion contracts or unfair bargains. The relation may expose the entrustor to risk even if he is sophisticated, informed, and able to bargain effectively. Rather, the entrustor’s vulnerability stems from the structure and nature of the fiduciary relation. The delegated power that enables the fiduciary to benefit the entrustor also enables him to injure the entrustor, because the purpose for which the fiduciary is allowed to use his delegated power is narrower than the purposes for which he is capable of using that power.\(^8\)

As though these striking differences were not enough, the obligation of good faith must necessarily remain cabined within the terms of the contract.\(^9\) Gordon Smith notes

the duty of loyalty requires the fiduciary to adjust her behavior on an ongoing basis to avoid self-interested behavior that wrongs the beneficiary. By contrast, the implied obligation of good faith and fair dealing requires loyalty to the other contracting party only to the extent that the terms of the contractual relationship reasonably contemplate the actions in question.\(^10\)

Smith continues, it is the added discretion a fiduciary has “that justifies the imposition of

\(^{68}\) See e.g. Dickerson, supra n. 2, at 133 ("Because the contractarian believes that a corporation is a nexus of contracts, it is logical that they would apply classic contract law concepts of good faith and fair dealing. Just as good faith is not waivable in contract law, it would be the mandatory core duty in corporate law.").

\(^{69}\) E.g. RUPA § 404 cmt. 4 ("The obligation of good faith and fair dealing is a contract concept, imposed on the partners because of the consensual nature of a partnership. It is not characterized, in RUPA, as a fiduciary duty arising out of the partners’ special relationship." (citation omitted)); ULPA 2001 § 305 cmt. subsec. (b) ("The obligation of good faith and fair dealing is not a fiduciary duty, does not command altruism or self-abnegation, and does not prevent a partner from acting in the partner’s own self-interest." (emphasis in original)).

\(^{70}\) Miller, supra n. 37, at 56; see also Dickerson, supra n. 2, at 119 ("[T]he requirement of good faith may coexist with self-interest, and need not contain the dependency feature of fiduciary duties."); Kleinberger, supra n. 24, at 636 (quoting ULPA 2001 § 305 cmt. subsec. (b)).

\(^{71}\) Frankel, supra n. 5, at 810 (emphasis in original).

\(^{72}\) In a similar vein, good faith is limited temporally. See e.g. Vestal, supra n. 55, at 242 ("[T]he nonfiduciary obligation of good faith and fair dealing under the Revised Act simply does not apply to prepartnership conduct." (footnote omitted)).

\(^{73}\) Smith, supra n. 7, at 1409–10 (footnote omitted).
more stringent loyalty obligations on fiduciaries than mere contracting parties.\(^\text{74}\)

Thus, scholars are quite correct to question the status of good faith as a fiduciary duty,\(^\text{75}\) and lament that "[i]t is contractarian confusion to equate the fiduciary duties of the common law and the UPA with the Uniform Commercial Code."\(^\text{76}\) To boot, if good faith is a background obligation inherent in contract, then one might plausibly argue that it is redundant even to mention it in the statutes governing unincorporated associations.\(^\text{77}\) The explanation for good faith’s inclusion, however, might be quite simple: it has been put in as a rhetorical tool to assure concerns about the decline of fiduciary duties. As one observer noted in the corporate context, “the emerging duty of good faith is best understood as a rhetorical device rather than a substantive standard.”\(^\text{78}\) The same phenomenon has replicated itself in the world of unincorporated associations.\(^\text{79}\)

Assuming, arguendo, that one can overcome this fundamental dissonance, “good faith and fair dealing” is difficult to define. For example, will good faith be a subjective standard?\(^\text{80}\) Will it be analyzed as a hypothetical outside the context of actual partnership relations?\(^\text{81}\) RUPA’s comments modestly admit that “[t]he meaning of ‘good faith and fair dealing’ is not firmly fixed under present law.”\(^\text{82}\) And commentators confirm that “[i]t is not yet clear what meaning the courts will attach to the phrase; it is not defined in RUPA or the commentary.”\(^\text{83}\) Even contractarians admit as much.\(^\text{84}\) To the extent that good faith can be defined, it will very likely set a very high threshold before relief will be granted, especially given that partners are expressly allowed to further their own interests.\(^\text{85}\)

New developments in corporate law suggest that a showing of bad faith likely

\(^\text{74}\) Id. at 1448; see also id. at 1410 (“[F]iduciaries are expected to be much more scrupulous about their self-interested behavior than mere contracting parties.”).

\(^\text{75}\) E.g. Dickerson, supra n. 2, at 133.

\(^\text{76}\) Vestal, supra n. 17, at 543–44.

\(^\text{77}\) The one possible difference, at least in the uniform laws, is that the waiver of good faith standards cannot be “manifestly unreasonable.” E.g. RUPA §103(b)(3)(i); see Dickerson, supra n. 2, at 145 (“This is not the pure contractarian model only if and to the extent that the RUPA good faith threshold, by requiring identification of standards not ‘manifestly unreasonable,’ is higher than the contract law standard.”); supra n. 18 and accompanying text.


\(^\text{80}\) See Vestal, Disclosure Obligations, supra n. 22, at 1610–12.

\(^\text{81}\) See id.

\(^\text{82}\) RUPA §404 cmt. 4.

\(^\text{83}\) Vestal, supra n. 40, at 511 (footnotes omitted); see Kleinberger, supra n. 24, at 635–36.

\(^\text{84}\) E.g. Eliza Feldman, Student Author, Your Partner’s Keeper: The Duty of Good Faith and Fair Dealing under the Revised Uniform Partnership Act, 48 SMU L. Rev. 1931, 1958 (1995); Robert M. Phillips, Student Author, Good Faith and Fair Dealing under the Revised Uniform Partnership Act, 64 U. Colo. L. Rev. 1179, 1218 (1993); Ribstein, Are Partners Fiduciaries? supra n. 60, at 221 (“The most difficult aspect of defining fiduciary duties involves distinguishing these duties from the general obligation of ‘good faith.’”). A similar problem remains in the corporate law context. Griffith, supra n. 78, at 29 (“[T]he precise meaning of good faith remains unclear.”).

\(^\text{85}\) E.g. RUPA §404(e); Vestal, supra n. 17, at 553 (“Paralleling the demise of the original fiduciary formulation was the insertion and expansion of language legitimating the unrestricted pursuit of self-interest.”); see supra n. 21 and accompanying text.
requires intentional wrongdoing. In the recent and highly publicized *Walt Disney* decision, the Delaware Court of Chancery held “the concept of intentional dereliction of duty, a conscious disregard for one’s responsibilities, is an appropriate (although not the only) standard for determining whether fiduciaries have acted in good faith.” Using the good faith standard is thus likely to require a showing of intent—hardly an easy standard to meet. Yet, none of this should come as a surprise: to the extent that good faith is a contractual concept, then *caveat emptor* of classical contract law applies.

Yet another problem with the statutes is that they gloss over a fundamental question: To whom or what is the duty of loyalty owed? For instance, RUPA speaks of a partner’s duties “to the partnership and the other partners,” and DRUPA mentions the duties of “a partner or other person to a partnership or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement.” Neither the uniform nor the Delaware laws, however, discuss the differences among duties owed to an entity and those owed to the other enumerated individuals.

Historically, it might have made sense to include duties to individuals since partnerships were considered an aggregate of individual partners rather than independent entities. Today, however, a cynic might be forgiven for wondering whether the gloss is purposeful, in an age where unincorporated entities are conceptualized as distinct entities. After all, mixing duties owed to the entity with those owed to other partners makes the general partnership, LP, LLP, or LLC seem more like a simple contract among individuals than a distinct entity to whom loyalty is owed. Conveniently, this

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86. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693 (Del. Ch. 2005). The Delaware Supreme Court has upheld the Chancery Court’s opinion. *In re Walt Disney Co. Derivative Litig.*, 2006 WL 1562466 (Del. June 8, 2006).

87. *Disney*, 907 A.2d at 755 (emphasis in original, footnote omitted); cf. Bratton, *supra* n. 4, at 1124 (noting that the good faith norm “asks materially less of corporate actors than does the fiduciary fairness norm.”). A similar situation has emerged in the law of close corporations. See *Mitchell*, supra n. 1, at 1680 (“[F]iduciary analysis in close corporation law has moved in three stages from the strict application of standards of loyalty, to judicial balancing of the legitimate interests of controlling shareholders with those of the minority, to the contemporary treatment of breach of fiduciary duty as intentional wrongful conduct.” (footnote omitted)). For more on fiduciary duties in close corporations, see *infra* nn. 136-139 and accompanying text.

88. Cf. Frankel, *supra* n. 61, at 1230 (“The distinction between entitlement to trust in fiduciary law and *caveat emptor* in contract law explains the different processes governing waiver of obligations.”).

89. RUPA § 404(b) (emphasis added). Similarly, ULPA 2001 discusses a general partner’s duties “to the limited partnership and the other partners.” ULPA 2001 § 408(b) (emphasis added). ULLCA refers to a member’s duties “to a member-managed company and its other members.” ULLCA § 409(b) (emphasis added).

90. Del. Code Ann. tit. 6, § 15-103(f) (emphasis added). Similarly, DRULPA speaks of the duties “of a partner or other person to a limited partnership or to another partner or to an other person that is a party to or is otherwise bound by a partnership agreement.” Del. Code Ann. tit. 6, § 17-1101(f) (emphasis added). DLLCA discusses the duties “of a member, manager, or other person to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement.” Del. Code Ann. tit. 6, § 18-1101(e) (emphasis added).

91. See *Kleinberger*, *supra* n. 24, at 634 (“The reference to ‘the other partners’ [in ULPA 2001] is misleading, however, because none of the listed rules say anything about partner-to-partner relations.”).

92. See *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) (“Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty.” (emphasis added)).

contractual bias dovetails nicely with the promotion of the contractual duty of good faith and fair dealing over the fiduciary duty of loyalty.\textsuperscript{94} Not to mention, it might appear onerous to impose mandatory duties toward both entities and individuals. Most importantly, such a stance also sidesteps debate as to whether imposing a non-waivable duty of loyalty solely toward the entity would be simpler and equally effective.\textsuperscript{95}

2. More Nuanced Contract Theory?

One way out might be sophisticated contract theory. Distinguished scholars have put forth various proposals. For example, Frankel contemplates a regime where a strict set of procedures would need to be followed before fiduciary duties can be waived:

\textit{[E]ntrustors may only waive fiduciary duties owed to them if they follow a two-step procedure.

First, entrustors must be put on clear notice that, with respect to the particular duties that they waive, they can no longer rely on their fiduciaries; instead, the entrustors must fend for themselves. Second, the fiduciaries must provide entrustors with information acquired by virtue of their position as fiduciaries to enable entrustors to make an informed independent decision regarding the waiver.}\textsuperscript{96}

Meanwhile, in seeking a middle ground between contractarian and fiduciary perspectives in corporate law, John Coffee argues that a series of trustworthy opt-out procedures be established,\textsuperscript{97} that “where major deviations from the traditional norms of corporate governance are to be adopted . . . the corporation should be required to sustain the burden of proving that the amendment was not against public policy,”\textsuperscript{98} and even that the level of scrutiny applied to the opt-out depends on when it occurs during the lifecycle of the firm.\textsuperscript{99} Going a step further, Mark Loewenstein suggests bifurcating the law of business associations: “The contractarian viewpoint ought to find its expression in alternatives to incorporation, which ought to provide maximum freedom of relationship among partners, rather than the relationship between an entity and its owners, supports private ordering rather than mandatory rules as the basis for firm governance.”\textsuperscript{\textsuperscript{100}}

\textsuperscript{94} In corporate law, “[h]istorically, the duty of loyalty is owed to the corporate entity and covers conduct pursued in a corporate capacity.” Bratton, supra n. 4, at 1092. On the other hand, the “duty of fair dealing”—as developed under the ALI Principles of Corporate Governance—“is owed to both the corporation and its shareholders.” \textit{Id.} at 1093 (footnote omitted); see also ALI Principles of Corp. Governance pt. V, at introductory n. b (1994).

\textsuperscript{96} Frankel, supra n. 61, at 1212.

\textsuperscript{95}John C. Coffee, Jr., \textit{No Exit?: Opting Out, The Contractual Theory of the Corporation, and the Special Case of Remedies}, 53 Brook. L. Rev. 919, 973 (1988) (“The intermediate position is to develop a multiplicity of model forms, all carrying a reputable brand name.”).

\textsuperscript{98} \textit{Id.} at 972 (footnote omitted).

\textsuperscript{99} \textit{Id.} at 924 (“[A]ttempts to opt out from the ‘default’ rules of corporate governance look very different (and more suspicious) if they occur at midstream (and are to be effected by charter amendment) than if such opting out occurs at the formation of the firm.”).
contract. . . Under this approach, corporations would remain entities with certain immutable mandatory terms; all other business entities would be contractarian in nature."\textsuperscript{100}

While these proposals are thought-provoking and might represent an improvement over our current regime, trying to extricate partnerships from fiduciary analysis—no matter what the mechanism—is problematic. Lawrence Mitchell writes:

The issue of the nature of partnership often has been described as one of a contract model versus a fiduciary model. The dominant conclusion that partnership is contractual appears to be taken to exclude the fiduciary. . . . But, if I may be so direct, this is a ridiculous conclusion. \textit{All fiduciary relationships originate in some form of consent, and nearly all of those that involve property or commerce are contractual}. . . . Thus, the fact that the partnership relationship is essentially contractual says absolutely nothing about the obligations and consequences of that relationship, other than that it is voluntary. To conclude anything further is utter nonsense.\textsuperscript{101}

Similarly, William Bratton warns of the "contractarian conjuring trick that turns positive law into contract and protective norms into \textit{ex ante} bargains."\textsuperscript{102} No matter how nuanced the contract theory, this logical inconsistency cannot be ducked.\textsuperscript{103}

\textbf{B. \ Outworn Economics}

Beyond its doctrinal confusion, a curious feature of contractarianism is the assertion among its proponents that it fits nicely within the precepts of modern economics. To their credit, the more sophisticated contractarians at least outline their economic assumptions. For instance, Larry Ribstein argues that "[a]s long as this choice relies on contracts between parties who are motivated to act in their own interests, bargain freely, and internalize the costs and benefits of the deal, enforcing contractual choice produces 'Pareto' wealth maximization."\textsuperscript{104} Unfortunately, such assumptions—typical of neoclassical law and economics of Chicago School fame—are heroic. Among other ills, they ignore externalities, pay little attention to bargaining realities, and are based on a static analysis of business relationships. Not to mention, they ignore transaction costs and institutional realities.\textsuperscript{105} If anything, this economic approach

\begin{footnotesize}
\begin{enumerate}
\item Mark J. Loewenstein, \textit{A New Direction for State Corporate Codes}, 68 U. Colo. L. Rev. 453, 471 (1997); \textit{cf.} Frankel, \textit{supra} n. 61, at 1267–68 ("I believe that law should provide society with two models for financial and economic interactions: the model of fiduciary relationship representing trust and dependency; and the model of contract relationship representing mutual suspicion, 'realistic' mistrust, and independence.").
\item Bratton, \textit{supra} n. 59, at 167–68.
\item \textit{See also} Frankel, \textit{supra} n. 61, at 1211 ("When we blur the distinctions between fiduciary and contract relationships, calling them by the same name, we tend to disregard the reasons for the different rules that govern them. Having forgotten these reasons, we are proposing seriously flawed rules that could come back to haunt us.").
\item Ribstein, \textit{supra} n. 79, at 395; \textit{see also id.} at 450.
\item Below, I focus on the intersection of neoclassical economics and the law of unincorporated associations. For a more general critique of conventional law and economics, as well as a discussion of new approaches, see Dibadj, \textit{supra} n. 66; Reza Dibadj, \textit{Beyond Facile Assumptions and Radical Assertions: A Case for "Critical Legal Economics,"} 2003 Utah L. Rev. 1155 (2003). For a new approach to welfare economics, including a detailed analysis of Pareto optimality, see Reza Dibadj, \textit{Weasel Numbers}, 27 Cardozo L. Rev. 1325 (2006).
\end{enumerate}
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represents a throwback to pre-realist legal formalism.

1. Externalities, Bargains, and Time

First, organizing business associations solely by means of private contract conveniently ignores externalities. As new research on private legal systems shows "[g]overnmental intervention ... may be crucial to mitigating degradation because private legal systems are at a disadvantage compared to the government in punishing degradation.

The government may also be an efficient regulator when degradation creates externalities that harm persons who are not constituents of the private legal system, and for whose interests, therefore, the private legal system might not cater. 106

Put more concretely in the context of business associations, organization via private contract allows more sophisticated "insiders"—for example, general partners in LPs or manager-members in LLCs—to impose externalities on their partners and co-members who might face imperfect information and a host of collective action problems. 107

Second, contractarians present an idealized vision of the bargaining principle and do not contemplate a dynamic analysis of firm behavior over time. Assuming equal bargaining power and informational symmetry among parties is unrealistic. 108 As Melvin Eisenberg points out, "[t]he bargain principle is based partly on the proposition that a fully informed party is the best judge of his own utility. If a party is not fully informed, or lacks the sophistication to understand the implications of his bargain, the bargain principle loses some or all of its force." 109 Not to mention,


107. Corporate law's enabling statutes engender a similar problem. See William W. Bratton & Joseph A. McMahon, The Equilibrium Content of Corporate Federalism 2 (European Corp. Governance Inst. Working Paper No. 23/2004 & Geo. L. & Econ. Research Paper No. 606481, 2004) (available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=606481) ("Externalities do occur because Delaware's strategy structurally favors management on allocational questions."). Of course, businesses can also impose externalities on other stakeholders such as employees, customers, and communities. See e.g. Kent Greenfield, September 11th and the End of History for Corporate Law, 76 Tul. L. Rev. 1409, 1419 (2002) ("Because the law largely stands aside in the formation of the corporate governance 'contract,' the parties with power, the shareholders and managers, can largely agree to whatever arrangement will benefit them. They can externalize the cost of the contract onto those who have less power to do anything about it."). It is debatable, however, whether imposing broader stakeholder analysis onto fiduciary law is a productive endeavor. See Dibadj, supra n. 41.

108. See e.g. Mitchell, supra n. 101, at 477 ("Among the conditions are the requirements that the parties have relatively equal information, or access thereto, and have relatively equal bargaining power, and that each of the parties expects the others to pursue their respective interests.").

109. Melvin Aron Eisenberg, The Structure of Corporation Law, 89 Colum. L. Rev. 1461, 1463 (1989) (footnote omitted); see id. at 1469-70; see also Vestal, supra n. 55, at 242 (noting that contractarianism assumes that the participants possessed perfect knowledge and maintains that the contractual allocation of power, even with its hidden consequence, represented the bargain-for understanding").
bargaining is often characterized by informality and misguided optimism. These oversights are symptomatic of not paying sufficient attention to the messy reality of how human beings actually behave. As William Bratton observes by applying the tools of game theory to bargains,

the contractarian description has a significant shortcoming. It gives us ex ante contracts across-the-board and thereby makes corporate governance entirely contractual without providing a description of the process by which corporate actors make contracts. It avoid

s the necessity of a theory of bargaining with two assumptions—bargaining is relatively cheap and competition will force parties to bargain their way into efficient arrangements. The mandatory/enabling discussion devolved on the weakness of these assumptions, concluding that information asymmetries, along with shareholder collective action and rational apathy problems, prevent effective bargaining and make certain actual contracts suspect. Bratton concludes “the game theoretic firm implies a new endorsement of the traditional dual justification of fiduciary law.”

The insights of game theory, moreover, extend far beyond the initial bargaining stage. Put simply, it is extremely difficult, if not impossible, to anticipate ex ante how the relationships within a business enterprise will evolve. At a very basic level, fiduciary law exists partly because firms cannot be modeled simply as basic contracts or simple agency relationships. Additionally, fiduciary law protects against the behavioral

11. Chicago School law and economics posits rational actors magically going about the business of maximizing utility. See e.g. Ron Harris, The Uses of History in Law and Economics 665 (Boalt Working Papers in Pub. L. Paper 21, 2003) (available at http://repositories.cdlib.org/boaltwp/21) (Chicagoans’ “research did not focus on studying the behavior of individuals, and the behavior of societies and basic social structures and trends was entirely beyond the scope of their research agenda.”). For a step toward organizational behavioral economics, see Dibadj, supra n. 59.
12. Bratton, supra n. 59, at 154; cf. Hillman, supra n. 110, at 442 (“Partnership law is not, as many believe, simply the ‘law of the agreement.’ The first step in evaluating the effectiveness of bargaining at the inception of a partnership is to recognize the limitations inherent in even serious attempts to develop an adequate partnership agreement.”).
13. Bratton, supra n. 59, at 153; see also id. at 154 (“Game theory implies a more thoroughgoing process challenge. It insists that bargaining processes often shape contractual results.”).
14. As I have argued elsewhere, firms are akin to a “messy smorgasbord of incomplete contracts.” Dibadj, supra n. 59, at 1505 (emphasis in original).
15. Interestingly, some writers analogize directly from agency law to advocate the primacy of contract in partnership law. See e.g. J. Dennis Hynes, Freedom of Contract, Fiduciary Duties, and Partnerships: The Bargain Principle and the Law of Agency, 54 Wash. & Lee L. Rev. 439, 441 (1997) (“[T]he law of agency provides a compelling analogy for the use of the bargain principle in the context of defining fiduciary relationships among partners.” (footnote omitted)). A careful reading of agency law, however, suggests otherwise: “Unless otherwise agreed, an agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency.” Restatement (Second) of Agency § 387 (1958). However, the law of agency is referring to individual transactions that might present a conflict, not broad ex ante waivers. As the commentary to the new draft emphasizes:

[A]n agreement that contains general or broad language purporting to release an agent in advance from the agent’s general fiduciary obligation to the principal is not likely to be enforceable. This is because a broadly-sweeping release of an agent’s fiduciary duty may not reflect an adequately informed judgment on the part of the principal; if effective, the release would expose the principal to the risk that the agent will exploit the agent’s position in ways not foreseeable by the principal at the time the principal agreed to the release.

Restatement (Third) of Agency § 8.06 cmt. b (6th tent. draft 2005). This stance is in marked contrast to the
quirks of economic actors. Noting that “complete contractual protection ex ante is not cost effective because of informational asymmetries and a long list of possible future relational problems,” Bratton warns that

[business relationships that depend on a motivational balance between self-interest and honor will have a potential for instability over time. This cannot be avoided through contract, because ex ante welfare calculations will never adequately identify or solve ex post problems of unreciprocal treatment. Given this, normative interventions under the fiduciary rubric that enforce a commitment to honor another’s interests play a coordinating role. Schol...
transaction costs and institutional realities. A standard move in the Chicago School repertoire is to assume a world of zero transaction costs and then argue that in such a world bargaining via private contract is ideal. Conventional law and economics selectively relies on the so-called Coase Theorem to support its position—much to R.H. Coase’s own repeated chagrin. Unfortunately, transaction costs cannot be conveniently assumed away. The link to fiduciary duties is straightforward and relates to the limitations of bargaining discussed above—“Courts supply fiduciary duties as default rules to reduce the costs associated with providing the fiduciary with incomplete instructions.” In other words, fiduciary law can be viewed “as a low transactions cost alternative to ad hoc bargaining between fiduciary and principal.”

A problem that closely parallels ignoring transaction costs is paying insufficient attention to the institutions in which economic activity occurs. Contractarians simply argue

[i]he antiwaiver argument is a harder sell in most closely held unincorporated firms in which terms are often negotiated or voted on face-to-face and approved unanimously. Fiduciary waivers in unincorporated firms closely resemble the sort of “real” contracts that anticontractarians have held out as models in the public corporation debate.

However, this analysis ignores a number of “vulnerabilities” that a fiduciary can exploit. To begin with, unincorporated associations—unlike public corporations—lack a ready capital market than can provide an “exit” strategy. They also often represent a large, undiversified portion of a partner or member’s assets.

There are also other institutional risks. Different unincorporated associations

123. Transaction costs include “search and information costs, bargaining and decision costs, policing and enforcement costs.” Carl J. Dahlman, The Problem of Externality, 22 J.L. & Econ. 141, 148 (1979).
124. The Theorem postulates that “[i]t is always possible to modify transactions on the market the initial legal delimitation of rights. And, of course, if such market transactions are costless, such a rearrangement of rights will always take place if it would lead to an increase in the value of production.” R.H. Coase, The Problem of Social Cost, 3 J.L. & Econ. 1, 15 (1960).
125. Coase has been blunt in his critique of the use his theorem has been put to, lamenting that the “world of zero transaction costs, to which the Coase Theorem applies, is the world of modern economic analysis, and economists therefore feel quite comfortable handling the intellectual problems it poses, remote from the real world though they may be.” R.H. Coase, The Firm, the Market, and the Law 15 (U. Chi. Press 1988) (emphasis added).
126. Smith, supra n. 7, at 1428 (footnote omitted).
127. Davis, supra n. 3, at 21; see also Bratton, supra n. 59, at 161 (“Since the corporation is a long-term relational contract that must cover all future states of the world, and costs prevent ex post negotiation of these terms, judicial intervention ex post promotes efficiency by supplying the necessary terms.”); Coffee, supra n. 97, at 970 (“[A]ny internal contracting process that sought to design a privatized substitute for the derivative action would have to write an extremely detailed contract and would have to develop and rely upon largely untested procedures.”); Hillman, supra n. 110, at 448.
128. Ribstein, supra n. 57, at 550 (footnote omitted).
129. See Dickerson, supra n. 2.
130. The fact that a partnership is easily dissolvable has conflicting implications. On the one hand, some argue that “[I]nterests in partnerships are highly liquid because any partner has the ability to dissolve the firm at any time.” Hetherington & Dooley, supra n. 118, at 3. However, it is important to bear in mind that the “reality departs from the theory . . . when a dominant partner is able to use dissolution as a means of capturing firm value without compensation to other partners.” Hillman, supra n. 93, at 187. In other words, the flip side of having the right to exit is the risk of hold up by an unscrupulous partner.
131. Hillman, supra n. 93, at 179 (“The participants’ investments in their firms often are substantial, nondiversified, and illiquid.”).
exhibit different additional vulnerabilities. General partnerships can be formed inadvertently, and partners “have unlimited personal liability for obligations of the partnership.” In addition, “[e]very partner (unlike a stockholder) by law has broad apparent authority to bind the partnership.... Partnership fiduciary duties similarly derive from the intertwined obligations and management rights that arise from each partner’s status as both an agent and a principal.” Additionally, LPs necessarily present the dangers inherent in the separation of management and ownership.

For their part, LLPs and LLCs, depending on how they are structured, can also separate “insider” managers from vulnerable “outside” investors. Interestingly, the great irony is that shareholders in close corporations—the corporate entities to which LLPs and LLCs most closely resemble—enjoy greater protections than participants in unincorporated associations. After all, the duty of loyalty in corporate law, at least nominally, is not waivable. Even beyond the usual protections afforded public shareholders, there is a long tradition of heightened concern for minority shareholders in close corporations. Far from echoing these concerns, the uniform laws and Delaware statutes for unincorporated associations belittle the duty of loyalty. This posture is, to

132. Dickerson, supra n. 40, at 434–35 (“A person can have the unlimited personal liability of a general partner without ever having had the subjective intent to form a partnership.”).
133. Smith, supra n. 7, at 1484.
135. See e.g. Kleinberger, supra n. 24, at 632 (“ULPA (2001) provides a blueprint for a manager-dominated enterprise in which passive investors depend on and generally defer to the manager.” (footnote omitted)).
137. In particular, both close corporations and unincorporated associations tend to be smaller entities where investors cannot exit since there is no public market for the securities. See Hillman, supra n. 93, at 178–79. Moreover, minority shareholders in close corporations closely mirror partners or members who do not make management decisions. See Hetherington & Dooley, supra n. 118, at 4–5. Hetherington and Dooley continue:

Even if the minority shareholder appreciates the risks of future dissension and attempts to protect his interest from its effects, bargaining for adequate contractual protections is no easy matter. Given the limitations of human foresight and knowledge, any attempt to describe the majority’s duties and obligations precisely is likely to leave the minority vulnerable to some overlooked form of exploitation while, at the same time, seriously impairing the efficiency of the firm by fettering management.

Id. at 37 (footnote omitted).
138. See Del. Code Ann. tit. 8, § 102(b)(7); infra n. 173 and accompanying text.
139. See e.g. Donahue v. Rodd Electrotype Co. of New England, 328 N.E.2d 505 (Mass. 1975); Smith v. Atlantic Properties, Inc., 422 N.E.2d 798 (Mass. App. 1981). For a critique of this line of cases, see Siegel, supra n. 134. At the other extreme, some commentators argue that given the illiquidity of investments in close corporations, even fiduciary duties are not enough protection for minority shareholders. See Hetherington & Dooley, supra n. 118, at 6 (“[W]e offer a model statutory provision requiring the majority to repurchase the minority’s interest at the request of the latter and subject to appropriate safeguards.”).
140. For instance, as Claire Moore Dickerson points out, ULLCA fails in the bigger picture. It has created a standard of performance for members of an LLC that is even lower than the standard currently in place for the owners in the traditional business entity having limited liability, the corporation. Further, it does so in a context where tax considerations limit the number of owners, thereby increasing the vulnerability of the owners who
put it mildly, curious.

In sum, contractarianism ignores externalities, assumes perfect bargaining within a static analytic framework, and slights transaction costs and institutional analysis. Contract cannot provide a coherent foundation upon which to base the laws of unincorporated associations. As one observer points out with some humor, contractarians have “the tendency to push their mode of analysis . . . far beyond its limits and to group more phenomenon under, and claim more uses for, a single analytical construct than does the Vegamatic shill on the carnival midway (‘It slices, it dices . . .’).”¹⁴¹ Analysts must not forget that “[t]he assumptions we make in this debate matter.”¹⁴²

C. Weak Policy

Beyond its confused doctrinal foundations and outworn economics, the transformation from loyalty into contract reflects weak public policy. It ignores the role of tradition, trust, and social norms. Instead, it offers the illusory allure of legal formalism.

1. Slighting Tradition, Trust, and Social Norms

The contractarian mantra is to extol the autonomy of contracting parties to the detriment of broader social institutions.¹⁴³ This position, however, ignores the role of tradition as a source of law. As Robert Clark points out in his study of contractual, elite, and traditional legal sources,¹⁴⁴ “contractualists analyzing legal institutions . . . tend not to acknowledge that noncontractual bases of legal rules could be both legitimate and important.”¹⁴⁵ In particular, “[t]raditions greatly reduce the very high costs of repeated

lack control.

Dickerson, supra n. 40, at 462. It remains to see to what extent the courts will read these statutes literally. Cf. Miller, supra n. 37, at 73 (“In light of the long-standing history of shareholder dissension in the close corporation context, and the abuse which has occurred in the context of limited partnerships, judicial intervention will invariably be needed to mediate disputes among limited liability company members.”); infra nn. 174–175 and accompanying text.

¹⁴¹. Branson, supra n. 58, at 94.
¹⁴². Vestal, supra n. 40, at 534.
¹⁴³. See Ribstein, supra n. 57, at 565 (“In fact, an external decisionmaker probably cannot do a better job than the contracting parties in determining the costs and benefits of waiver in particular circumstances.” (footnote omitted)).
¹⁴⁴. Clark provides a taxonomy:

In contractual rule making, the parties subject to a particular set of rules create them for themselves, by their agreement.

In elite rule making, rules are made for the subject parties by other persons who consider themselves to be experts, leaders, or persons in authority.

Traditional rules are rules imposed by prior generations of rule makers (who were usually, but not necessarily, elites).

¹⁴⁵. Id. at 1746.
discovery, learning, and rational decisionmaking by individuals; after all, the optimal control of discretionary power possessed by those who act on behalf of others is as old and basic as human nature itself, and certain general principles evolved to cope with that problem, such as the fiduciary duties of care and loyalty, have been a long time in the making.

Overemphasis on contract also erodes trust. It is important to remember that "contract is the language of autonomy. Thus contract begins from a situation of distrust, because one is presumed to rely upon one’s self for protection; one’s contracting partner is, after all, indifferent to one’s welfare.” By contrast, the duty of loyalty, as its name might imply, is about fostering trust. Trust inherently creates an ambiance that “reduces uncertainty in an enormously complex world” and leads to stable business relationships over time. Contract does not.

Contractarians will no doubt protest the importance placed on tradition and trust. After all, the argument goes: “Don’t these represent extralegal norms?” The response, as I have developed in detail elsewhere, is that the law is, in part, a device to foster positive social norms and repel antisocial ones. Fiduciary duties necessarily bring with them a moral component. We choose to abandon these characteristics at our own peril. As Mitchell notes, “[t]he debate really is about the way we, as a society, believe that people can and should conduct themselves in business relationships and the extent to which we are willing to use the law to encourage and, if necessary, compel

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146. Id. at 1731. Framed in economic parlance, tradition can reduce transaction costs.
147. Id. at 1745; cf. Davis, supra n. 3, at 22 (“Where the regime is one of standardized form, data is available from the experiences of countless other relationships operating under a comparable framework.”); Eisenberg, supra n. 109, at 1466.
148. The effect is particularly pernicious when contractarianism is combined with procedural maneuvers. As Mitchell writes,

[there are two separate, but ultimately related, legal causes of the erosion of trust in our society: an overreliance in our legal system on procedural fairness, and an increased reliance on the law of contract... As the fairness test has evolved, it permits corporate fiduciaries to profit from self-dealing with the corporation as long as the fiduciaries can demonstrate that they have followed processes which themselves are formally fair, regardless of the actual outcome.

Lawrence E. Mitchell, Trust. Contract. Process., in Progressive Corporate Law, supra n. 56, at 185, 186; see also Dickerson, supra n. 2, at 155.
150. Mitchell, supra n. 101, at 480.
151. See id.
152. Cf. Miller, supra n. 53, at 1619 (“The contractarian model... fail[s] to consider the human relationships that develop in privately owned businesses.”).
153. See e.g. Ribstein, Are Partners Fiduciaries? supra n. 60, at 233–35.
154. See Dibadj, supra n. 59; see also Claire Moore Dickerson, Cycles and Pendulums: Good Faith, Norms, and the Commons, 54 Wash. & Lee L. Rev. 399, 412 (1997) (“If norms were entirely self-enforcing, laws to enforce them would be redundant.”); Miller, supra n. 53, at 1647–48 (“A broader statement of duties may better reflect society’s norms of ethical behavior than a narrower formulation of responsibilities.”) (footnote omitted)). For a general discussion of how law can help foster rather than hinder trust, see Frank B. Cross, Law and Trust, 93 Geo. L.J. 1457 (2005).
155. See e.g. Frankel, supra n. 5, at 830 (“This moral theme is an important part of fiduciary law. Loyalty, fidelity, faith, and honor form its basic vocabulary.”) (footnote omitted)); Hillman, supra n. 110, at 456 (“There is a moral theme to the concept of fiduciary responsibilities.”) (footnote omitted)).
156. See Vestal, supra n. 40, at 497.
them to conform to that level of conduct." 157

2. The Allure of Legal Formalism

It should hopefully be apparent by now that fiduciary duties are borne of common sense and realism:

[F]iduciaries occupy neither the position of parents nor that of priests. Fiduciaries are required to identify with the interests of entrustors only to the extent that the fiduciaries exercise dominion over the entrustors or their property, and to a lesser extent, with respect to the quality of their services. ... The "goodness" expected of fiduciaries consists of refraining from taking what is not theirs, without permission. Fiduciaries must meet the obligations even if the entrustors do not police their activities. This is honesty, not altruism. 158

Contrary to what contractarians might have us believe, the fiduciary tradition does not represent some romantic, antiquated ideal. Instead, it expresses pragmatism:

Business people and lawyers understand the "smell test" and know that the traditional fiduciary duties make it risky to cut corners too closely. Far from being naively aspirational, those duties serve to guide the parties to a standard of behavior that reduces the need to monitor. 159

As Mitchell writes, fiduciary duty "is an attitude, not a rule" to "provide a legal incentive for the parties to get along by forgoing opportunistic conduct." 160 Contrast this perspective with that of the contractarians, who view business associations as a series of highly formal arrangements, reminiscent of nineteenth-century contract theory, where form trumps function. 161

Why the allure? At the broadest level, the contractarian push in the law of unincorporated associations is part of a general movement in law and economics, epitomized by James Buchanan's pioneering work, to lionize contract at the expense of public law. Buchanan's core postulate is that "economics comes closer to being a 'science of contract' than a 'science of choice,'" 162 where the "unifying principle becomes gains-from-trade, not [social] maximization." 163 The consequence of a

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158. Frankel, supra n. 61, at 1228–29 (emphasis in original, footnote omitted); see also Bratton, supra n. 59, at 144 (Cardozo in Meinhard "represents the wise common law judge whose state-imposed standard of honor holds out no serious threat to ordinary money-making pursuits.").
159. Dickerson, supra n. 2, at 156.
162. Cf. Coffee, supra n. 97, at 937 ("One ironic generalization seems justified about those economists who view the firm as a private contract: they often seem to ignore modern contract law in favor of an almost nineteenth century, stereotypical notion of what contract law permits."); Dickerson, supra n. 2, at 152 ("It may also be that to import contractarian theories into partnership law today is analogous to using formalist concepts in the 1930s.").
164. Id. (emphasis omitted); see also James M. Buchanan, Contractarian Political Economy and Constitutional Interpretation, 78 Am. Econ. Rev. 135 (1988). In many respects, contractarianism is a bold extension of Hayek's argument that given the decentralization of knowledge in society, dispersed decision-making loci, namely markets, are the preferred means of allocating resources. See F.A. Hayek, The
contract-based society, with its concomitant over-reliance on market allocations— as opposed to a fiduciary one—is plain. As Frankel reminds us, “[u]nlike status and contract societies, a fiduciary society emphasizes not personal conflict and domination among individuals, but cooperation and identity of interest pursuant to acceptable but imposed standards. . . . A contract society values freedom and independence highly, but it provides little security for its members.” The desire to waive the duty of loyalty, then, is simply a specific manifestation of a broader ethic.

There is an additional fascinating twist to the story. The contractarian push has come, by and large, not from the courts, but from the legislatures. As just one prominent example, when the Delaware Supreme Court in *Gotham Partners* suggested that fiduciary duties could not be entirely eliminated, the Delaware legislature promptly passed amendments in 2004 allowing the elimination of the duty of loyalty. When it comes to courts, even contractarians admit that “[t]here has always been a tension regarding the extent to which a partner’s fiduciary duty of loyalty can be varied by agreement, as contrasted with the other partners’ consent to a particular and known breach of duty.” Judges might give greater weight to fiduciary law than the text of the statutes might otherwise suggest because of tradition—in part a recognition that analyzing relations of dependency is an inherently context-dependent task to which fiduciary law has been applied and developed over time.

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*Use of Knowledge in Society*, 35 Am. Econ. Rev. 519 (1945).

165. See e.g. Herbert Hovenkamp, *Knowledge about Welfare: Legal Realism and the Separation of Law and Economics*, 84 Minn. L. Rev. 805, 850 (2000) (“For the contractarian, markets are unambiguously the preferred way to allocate resources (when the social contract is negotiated, markets receive unanimous consent), and the government intervenes only in the extraordinary case where everyone agrees that intervention is in order.”).

166. Frankel, supra n. 5, at 802.

167. *Gotham Partners, LP v. Hallwood Realty Partners, LP*, 817 A.2d 160, 168 (Del. 2002). Even opinions that squarely espouse contractarianism contain hints of ambivalence. See e.g. Miller v. *Am. Real Estate Partners, LP*, 2001 Del. Ch. LEXIS 116 at *29 (Del. Ch. Sept. 6, 2001) (“I conclude that the Partnership Agreement fails to preclude the operation of the fiduciary duty of loyalty with sufficient clarity, even in situations when the General Partner has the contractual power to act in its sole discretion.”); *McConnell v. Hunt Sports Enters.*, 725 N.E.2d 1193, 1216 (Ohio App. 10th Dist. 1999) (“In general terms, *members of limited liability companies owe one another the duty of utmost trust and loyalty. However, such general duty in this case must be considered in the context of members’ ability, pursuant to the operating agreement, to compete with the company.*” (emphasis added)).

168. See supra pt. II.B. For more on these amendments, see Ribstein supra n. 24, at 952-53.

169. Ribstein, supra n. 24, at 946 (quoting RUPA § 103 cmt. 4) (internal quotation marks omitted); cf. Miller, supra n. 53, at 1613 (“The primary message of this Article is that the courts are central to all LLC models, including Delaware’s contractarian paradigm, and are leading the way toward balancing the interest in contractual freedom with the need to constrain opportunistic and deceptive conduct through the development of a minimum mandatory core of acceptable business conduct.”).

170. As Robert Clark points out:

> Suppose a corporation attempts a charter amendment excusing directors and officers from the judicially developed fiduciary duty of loyalty.

A traditionalist judge might respond [that] they do not feel right and, as I read the case law precedents, fiduciary duties have generally been assumed by prior judges to be nonnegotiable. Clark, supra n. 144, at 1740-41.

171. Daniel Kleinberger points out that “[f]iduciary duty is context-sensitive, because dependency and vulnerability form the duty’s core raison d’être.” Kleinberger, supra n. 24, at 632 (footnote omitted). For instance, “[a] restriction that passes statutory muster where the partners are genuinely co-equals may be manifestly unreasonable where all but one partner have committed themselves to total dependence on that one.
A similar pattern has manifested itself in corporate law. When the Delaware Supreme Court, in the famous Van Gorkom case,\(^\text{172}\) found directors to be grossly negligent under a duty of care analysis, the Delaware legislature passed § 102(b)(7), allowing corporations to contract out of the duty of care, at least as to monetary liability.\(^\text{173}\) Moreover, when state legislatures adopted “safe harbor” statutes that allow corporate managers to insulate themselves from liability for duty of loyalty violations through procedural mechanisms and thereby immunizing them from any “fairness” inquiry,\(^\text{174}\) many jurisdictions—despite the explicit language of the statutes—continue to scrutinize the facts under a broad fairness analysis.\(^\text{175}\)

Why would legislatures push contractarianism? It is important to remember that legislatures themselves generally do not draft business laws. Committees of private lawyers, often representing large firms, do.\(^\text{176}\) This might help explain a seeming incongruity in the new laws. As Allan Vestal notes, “[s]cholars generally agree that the Revised Act should be written for partnerships that are small in size, closely held by relatively unsophisticated individuals, and modestly capitalized.”\(^\text{177}\) Yet, “certain provisions of the Revised Act, such as the fiduciary duty sections, appear tailored to larger, more affluent enterprises with relatively sophisticated participants.”\(^\text{178}\) Similarly, Sandra Miller observes that a “narrower contract-oriented approach to fiduciary duties may inappropriately serve the interests of the more affluent and may be unrealistic in terms of the practical usage of the LLC by certain members of the business community”\(^\text{179}\)—after all, “the contractarian approach of relying on contractual provisions to protect against opportunistic conduct may be more well suited to big business than to the work-a-day world of small business.”\(^\text{180}\)

Some scholars go even further. Mitchell asks whether

RUPA was drafted more to benefit lawyers by giving them a fail-safe backstop than to benefit the parties themselves. Moreover, by severely limiting fiduciary obligation, RUPA benefits sophisticated lawyers and their clients, not only allowing them to take advantage of the weaker parties, but providing them with winning arguments in the case of ambiguous drafting.\(^\text{181}\)

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\(^{172}\) Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

\(^{173}\) Del. Code Ann. tit. 8, § 102(b)(7). This provision maintains, however, that the duty of loyalty is mandatory.


\(^{175}\) E.g. Cooke v. Oolie, 1997 Del. Ch. LEXIS 92 (Del. Ch. June 23, 1997); In re Wheelabrator Technologies, 663 A.2d 1194 (Del. Ch. 1995); Cookies Food Prods., Inc. v. Lakes Warehouse Distrib., Inc., 430 N.W.2d 447 (Iowa 1988); see also Bratton, supra n. 4, at 1088 (“Courts, however, have not read the [safe harbor] statutes literally. They have consistently construed them to permit direct judicial review for fairness despite disinterested-director approval.” (footnote omitted)).

\(^{176}\) For a discussion of this phenomenon, see Dibadj, supra n. 41.

\(^{177}\) Vestal, supra n. 55, at 238 (footnote omitted).

\(^{178}\) Id. at 239.

\(^{179}\) Miller, supra n. 53, at 1646.

\(^{180}\) Id. at 1647.

\(^{181}\) Mitchell, supra n. 101, at 479.
Similarly, Frankel points out that in a contractarian world, "[e]ntrustors must expressly protect themselves by contracts—a bonanza to the legal profession—or else their fiduciaries can use the entrusted property for their own benefit." 182 Mitchell's and Frankel's words are reminiscent of a warning given by Justice Harlan Stone in the wake of the excesses of the 1920s:

But when we know and face the facts we shall have to acknowledge that such departures from the fiduciary principle do not usually occur without the active assistance of some member of our profession, and that their increasing recurrence would have been impossible but for the complaisance of a Bar, too absorbed in the workaday care of private interests to take account of these events of profound import or to sound the warning that the profession looks askance upon these, as things that "are not done." 183

Might the current attack on the duty of loyalty be reconceptualized as a "regulatory giving" from the legislatures to a small class of lawyers? 184

IV. CONCLUSION

The law of unincorporated associations is undergoing a major shift. The uniform laws, and to an even greater extent the Delaware statutes, seek to reduce dramatically, if not eliminate, the fiduciary duty of loyalty. This transformation is part of a broader trend toward treating business associations as mere contracts. 185 Unfortunately, the rhetoric of contractarianism exhibits doctrinal confusion, outworn economics, and weak policy.

The fiduciary principle has served partnership law well for over a century. By contrast, the recurring scandals in corporate governance stem in large measure from the unfortunate relaxation of fiduciary duties applicable to corporations. 186 As Justice Stone reflected over seventy years ago:

I venture to assert that when the history of the financial era which has just drawn to a close comes to be written, most of its mistakes and its major faults will be ascribed to the failure to observe the fiduciary principle, the precept as old as holy writ, that "a man cannot serve two masters." . . . Yet those who serve nominally as trustees, but relieved, by clever legal devices, from the obligation to protect those whose interests they purport to represent, corporate officers and directors who award to themselves huge bonuses from corporate funds without the assent or even the knowledge of their stockholders, reorganization committees created to serve interests of others than those whose securities they control, financial institutions which, in the infinite variety of their operations, consider only last, if at all, the interests of those whose funds they command, suggest how far we have ignored the necessary implications of that principle. 187

182. Frankel, supra n. 61, at 1267.
184. For a detailed discussion of the concept of a "regulatory giving," see Reza Dibadj, Regulatory Givings and the Anticommons, 64 Ohio St. L.J. 1041 (2003).
185. See Dibadj, supra n. 59.
186. For a detailed discussion of the importance of fiduciary duties in corporate law and a case for their reconstruction, see Dibadj, supra n. 41.
Stone’s words are at least as relevant today as they were in 1934. It would, after all, stretch the imagination to argue that the perpetrators of the most recent slew of corporate scandals were either careful or loyal. In corporate law, the unintended consequence of relaxing fiduciary duties has been to impose increasingly burdensome layers of mandatory regulation to stem malfeasance—notably securities regulation—with mixed success.

The need for increasing layers of regulation may very well emerge to be even more acute for unincorporated associations than for corporations. The great irony, of course, is that cases imposing more robust fiduciary duties on corporate insiders would analogize to the higher duties historically inherent upon partners. Today, the situation is precisely the opposite: at least nominally, corporate law still makes the duty of loyalty mandatory, whereas the new partnership laws are fighting hard to make it waivable. Unsurprisingly, the law is already finding it necessary to impose layers of regulation to compensate for eviscerated fiduciary duties. Damage control has begun. The alternative is to embrace a strong duty of loyalty as a necessary “regulatory” adjunct to private ordering.

188. Some might be tempted to argue that corporate fiduciary duties are a bit quaint in an era increasingly dominated by institutional shareholders. Quite the opposite is true. A pioneer in the world of investment funds, John Bogle, warns the radical change from an ownership society dominated by individual investors to an intermediation society dominated by professional money managers and corporations has not been accompanied by the development of an ethical, regulatory and legal environment that requires trustees and fiduciaries, as agents, to act solely and exclusively in the interests of their principals.

John C. Bogle, Individual Stockholder, R.I.P., Wall St. J. A16 (Oct. 3, 2005); see also Bratton, supra n. 4, at 1085 (“[T]raditional fiduciary norms still play a vital role in corporate governance.”).


190. See e.g. Dibadj, supra n. 41; Frankel, supra n. 61, at 1245 (“[T]he Securities Acts put market fiduciaries and contract actors on such a level playing field by prohibiting waivers of rights under the Acts.”) (footnote omitted).

191. See Dibadj, supra n. 41; cf. Eisenberg, supra n. 109, at 1524 (“It would be a normative mistake to think that under prevailing circumstances . . . publicly held corporations would continue at their present level of success if the legal constraints on traditional and positional conflicts that have contributed to that success were removed.”).

192. See e.g. Donahue, 328 N.E.2d at 515 (“[W]e hold that stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another.”) (footnotes omitted); Hillman, supra n. 93, at 177; Siegel, supra n. 134, at 444–45.

193. E.g. Del. Code Ann. tit. 8, § 102(b)(7); see supra n. 173 and accompanying text.

194. This has begun with the classification of LLC interests as securities, especially where there is separation of management and ownership, as in manager-managed LLCs. See e.g. Cohen, supra n. 53, at 467 (“Unlike piercing and fiduciary duty laws, security laws related to LLCs have been tested by the courts and arguments in favor of regulation have defeated arguments in favor of freedom of private ordering.”).

195. Cf. Vestal, Disclosure Obligations, supra n. 22, at 1568 (“The failure of the contractarian revolution in partnership law—if that is indeed what we are seeing—is another indication of more general dissatisfaction with contractarian theory when the theory is applied to concrete legal problems.”); Vestal, supra n. 17, at 553 (“The most spectacular error of the Revised Act is its exclusion of the core fiduciary principle and the embrace of its antipode.”).

196. Cf. Miller, supra n. 53, at 1652–53 (“Elastic concepts such as fiduciary duty are not out of place in a system designed to enforce contractual expectations within the business entity, but rather are the very backbone of our system of private ordering.”) (footnote omitted).