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Each partner in an at-will partnership can obtain a cash payout of his interest at any time. The corporation, by contrast, locks in shareholder capital, denying general payout rights to shareholders unless the charter states otherwise. What explains this difference? This Article argues that partner payout rights reduce the costs of two other characteristics of the partnership: the non-transferability of partner control rights, and the possibility for partnerships to be formed inadvertently. While these characteristics serve valuable functions, they can introduce a bilateral-monopoly problem and a special freezeout hazard unless each partner can force the firm to cash out his interest. The corporation lacks these characteristics: shares are freely transferable, and no one can commit capital to a corporation without intending to do so. Therefore, in most corporations the costs of shareholder payout rights—which would include the cash-raising burden and a hazard of appraisal arbitrage—would exceed the benefits.

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INTRODUCTION

In her celebrated article *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, Margaret Blair drew the attention of scholars to one of the distinctive attributes of the corporate form: that it locks in capital, denying each shareholder the power to obtain a payout of his investment without the consent of the board of directors.[1] By locking in shareholder capital, the corporate form creates a freezeout hazard if the board refuses to authorize distributions and the shareholders cannot find buyers for their shares.[2] However, Blair emphasized that capital lock-in can also provide an important economic benefit. Expanding upon a thesis introduced by Henry Hansmann and Reinier Kraakman,[3] she showed that capital lock-in protects the corporation's going-concern value.[4] In particular, she argued, it provides this benefit by preventing shareholders from withdrawing assets with firm-specific value.[5]

The idea that a business can protect its going-concern value by organizing as a corporation has proven to be highly influential. Besides expanding scholars' understanding of the economic functions served by the corporation in particular, it has led some scholars to inquire

1. Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387 (2003).

2. *Id.* at 388:

> The phrase "lock-in," when used in the context of corporate law, generally has a negative meaning, suggesting the dreaded fate of a minority shareholder in a closely held corporation who cannot sell her shares . . . and cannot compel the corporation to pay out any of its income or assets to shareholders.

3. Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 403–04 (2000) (describing how "liquidation protection" in the corporation preserves going-concern value).

4. Blair, *supra* note 1, at 391–92.

5. *Id.* at 393–94.

whether the partnership, the traditional organizational alternative to the corporation, might also protect going-concern value, albeit by different means. Unlike the corporation, the partnership does not lock in financial capital: the default rule is that any partner may withdraw at any time and thereupon receive a payout of his interest in the business. However, in an innovative recent article, Morgan Ricks showed that partnership law employs a pair of rules that safeguard firm-specific assets when a partner exercises his payout right.[6] Both rules were developed by courts in the nineteenth century, and both remain in effect today. The first rule is that a departing partner must be paid out in cash unless all the partners agree to an in-kind distribution of the partnership's property instead.[7] And the second rule is that, if a partner withdraws, any partner may demand an auction of the whole firm, intact.[8] The winner of the auction—which will often be the non-withdrawing partners—can then continue to operate the firm without interruption. As described by Ricks, these features of partnership law preserve the underlying business's particular "asset configuration," which includes its holdings of complementary assets.[9]

Besides its asset configuration, a second potential source of a business's going-concern value is its contractual relationships. A firm can use contracts to capture the surplus from relationship-specific investments and to lock in favorable supply prices. I show in this Article that partnership law also protects this source of going-concern value when a partner withdraws.[10] Even though the default rule is that a partner's withdrawal dissolves the partnership and leads to its termination, courts have, since the nineteenth century, consistently held that the partnership's contracts remain enforceable, by and against the partners jointly, unless the contracts say otherwise. As a result, one partner cannot hold up the others to the extent of the value of the firm's profitable contracts by threatening to pull out. In combination with the rules preserving the partnership's asset configuration, this contract-survival rule locks in the partnership's *real* capital—its investments in specialized assets and valuable contractual relationships—even while permitting withdrawals of *financial* capital.[11]

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6. Morgan Ricks, *Organizational Law as Commitment Device*, 70 VAND. L. REV. 1303, 1309, 1336 (2017).

7. *Id.* at 1337.

8. *Id.*

9. *Id.* at 1336.

10. See the discussion in Section I.D.3, *infra*.

11. Ricks described the distinction in this way:

The recent recognition among scholars that the partnership also employs methods for safeguarding going-concern value further confirms the insight provided by Hansmann, Kraakman, and Blair that the protection of such value is one of the core functions of the law of business organizations in the modern economy. An analogy can be made to the development of writing, arguably the most important invention of ancient civilizations. Writing is a technology so useful that it was independently invented at least four times on three different continents.[12] Although the four resulting systems of writing employed different scripts and operated in different ways, they all served the same essential function. Similarly, preserving a firm's going-concern value is such a valuable function of organizational law that corporate law and partnership law each developed its own legal mechanism for serving that function. In the corporation, the mechanism is its straightforward lock-in feature, whereby the board rather than shareholders decides when capital will be distributed. In the partnership, the mechanism is the set of rules that permit a departing partner to withdraw his financial capital without also breaking up the business's real capital.

Of course, the fact that partnership law has developed rules for shielding the principal components of going-concern value when a partner withdraws does not mean that the partner's exercise of his payout right is costless. Most obviously, the exercise of the right forces the partnership to come up with the cash needed to honor the right. And, perhaps more importantly, it requires resort to an independent valuation method when the partners disagree about how much the departing partner's interest in the firm is worth. The two main valuation options are sale of the whole firm—the traditional method in partnership law—and appraisal by a third party such as a judge or arbitrator.[13] Both methods have downsides: they generate transaction

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> [Margaret] Blair argues convincingly that the corporate form became popular among business organizers in the nineteenth century largely because the corporate form, as compared to the (readily dissolvable) partnership, offered a superior means to lock in financial capital. In essence, my claim is that the traditional partnership did in fact offer capital lock-in—albeit lock-in of a comparatively weak form when judged against the corporation.

Ricks, *supra* note 6, at 1308–09.

12. *See* Stephen Chrisomalis, *The Origins and Co-Evolution of Literacy and Numeracy*, *in* THE CAMBRIDGE HANDBOOK OF LITERACY 59, 62 (Nancy Torrance & David R. Olson eds., 2009). In order, those places were Mesopotamia (circa 3400 B.C.), Egypt (circa 3250 B.C.), China (1200 B.C.), and Mesoamerica (by 500 B.C.). *Id.* at 63, 64, 66.

13. The Revised Uniform Partnership Act of 1997 ("RUPA") provides for third-party appraisal rather than sale of the whole firm when a partner dissociates from the partnership not through intentional withdrawal but rather on account of death or personal bankruptcy. REVISED UNIF. P'SHIP ACT § 701(b) (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1997).

costs, introduce misvaluation risk, and invite opportunism, the form of which depends on the method employed. These various drawbacks of payout rights suggest the following question: Why does partnership law continue to grant such rights by default rule, rather than simply locking in financial capital as the corporation does?

In this Article, I propose an answer to this question. I argue that payout rights for partners complement two other characteristics of the partnership: its restriction on transfers of partner control rights; and the possibility for partnerships to be formed inadvertently, without each partner's intention to convey his property to a distinct legal entity. Although these two characteristics serve important functions in the partnership, they also introduce a bilateral-monopoly problem and a heightened freezeout hazard if each partner cannot withdraw and obtain a cash payout of his interest at any time.

The rule that no partner may transfer his control rights without permission from all the others is a corollary of the principle that no person may join a partnership without all partners' consent. That principle makes sense given that any partner can use partnership property, bind the partnership in contract, and incur tort liabilities for which all partners are liable. However, if partners lacked payout rights, then the principle would produce a bilateral-monopoly problem whenever a partner wished to exit, since the other partners are, collectively, the only possible buyers of his control rights.[14] The other partners could simply stonewall the exiting partner, perhaps out of spite (after all, he wants to leave them). Or, even if they were willing to negotiate, the haggling could be protracted because neither side would face competition from other possible buyers or sellers. The payout right breaks the deadlock: it forces the non-withdrawing partners to come to the bargaining table, and it simplifies negotiations by shrinking the bargaining space to the positive difference, if any, between the departing partner's estimate of the price that a sale of the firm would assign to his interest and the remaining partners' estimate of that price.

The rule whereby co-owners of a business can be deemed to have formed a partnership even if they did not intend that result also serves a valuable function, as it forces co-owners of a business to bear the costs of injuries caused by persons acting on their behalf, and it prevents unjust enrichment of some owners at the expense of others. But the rule would be unduly harsh if the resulting partnership locked in the

14. Notice that the default rule prevents the remaining partners from competing against each other to buy the departing partner's control rights, as they all must consent to any transfer of those rights.

owners' capital, because a coalition of owners that controlled this partnership could then freeze out the others. By granting payout rights as a default rule, partnership law ensures that business owners assume freezeout risk only when they have consented to do so, such as by agreeing to a partnership for a term or by conveying their property to what they know to be a distinct legal entity.

The corporation lacks both of these attributes of the partnership. All rights appurtenant to share ownership—comprising both cash-flow rights and control rights—are freely transferable along with the shares themselves, a benefit of incorporation that corporate law makes possible by assigning management powers and agency authority to the board of directors, and by limiting control by shareholders to the election of directors and ratification of certain board-initiated transactions. In consequence, when a shareholder wishes to exit, his fellow shareholders (or, acting on their behalf, the corporation itself) are not the only possible buyers of his full bundle of rights. In addition, a corporation cannot be formed unintentionally, and no investor can commit his capital to a corporation without intending to do so. Would-be shareholders are thus on notice of the freezeout hazard presented by the corporate form and can adjust for it in the price they pay for their shares or by insisting on payout rights as a condition of the purchase.

Not only would payout rights not serve the same special purposes in the corporation that they serve in the partnership, but they would also be costlier. Because corporate shares are, by default rule, freely transferable, they would create an onerous hold-up hazard if they came with payout rights. Investors could then buy shares for the sole purpose of threatening to force the corporation to buy the shares back, which would require the corporation not just to come up with the needed cash but also to employ an independent valuation method that could overvalue the shares or force a change in control, depending on the method used. Therefore, in most corporations the costs of shareholder payout rights would greatly exceed the benefits. The contrast between the partnership and corporation in this regard suggests that payout rights and free transferability of equity interests are mutually incompatible sources of liquidity for a firm's investors. Many firms will grant one or the other, but almost none will allow both.

After presenting my arguments with respect to the corporation and the traditional partnership, in the second Part of this Article I assess the capital lock-in rules in the three limited-liability alternatives to the corporation now available to business organizers: the limited partnership, the limited liability company ("LLC"), and the limited liability partnership ("LLP"). Notably, all three of these forms of business organization are like the partnership in that they restrict transfers of owner control rights. But they are also like the corporation in that they cannot be formed without the formality of a public filing. They therefore allow us to investigate whether restrictions on transfers of owner control rights are alone sufficient to make owner payout rights a desirable organizational feature, even in entities that cannot be formed inadvertently.

Notably, when each of these three limited-liability alternatives to the corporation first appeared in American law, its governing statutes typically—that is, in most jurisdictions—provided for owner payout rights. This observation suggests that the statutory drafters believed that a prohibition on unilateral transfers of owner control rights was sufficient to make payout rights the preferred default setting for the majority of businesses that would adopt the form as their organizational dress. However, with the introduction of the latest of the three forms—the LLP—in the 1990s, the field of substantially similar business forms had become crowded, creating a need for differentiation. Accordingly, in the last twenty years, numerous states have eliminated the payout right as the default setting in the limited partnership and LLC while retaining it in the LLP. In effect, the drafters of the latest statutes governing the limited partnership and LLC have supplied new majoritarian default rules tailored not to the full set of businesses that wish to organize as a limited-liability alternative to the corporation, but rather to the subset of those businesses that do not, for whatever reason, also prefer the default rules of the LLP. Such changes have increased the likelihood that the founders of any particular business will be able to select an entity form whose organizational default settings, including those regarding lock-in of financial capital, coincide with the founders' preferences.

I. CAPITAL LOCK-IN AND GOING-CONCERN VALUE

A business's going-concern value can have multiple components, and rules that circumscribe capital withdrawals by owners protect those components in different ways. In the discussion that follows, I describe the main components of going-concern value, and I then evaluate the scholarly literature on capital lock-in by analyzing how, and to what extent, the corporation and partnership protect each of those components.

A. The Pieces of Going-Concern Value

When scholars or financial analysts discuss a firm's "going-concern value," they typically have in mind the present value of the firm if it is allowed to continue in its current state, without interruption of its operations. Going-concern value is usefully contrasted with "liquidation value," which is the theoretical amount of cash that would be raised if a firm were shut down and its assets sold off piecemeal at prices reflecting those assets' best alternative uses. Because the firm's liquidation value could, in theory, be realized at any time by shutting down the firm, it represents the opportunity cost of allowing the firm to continue to operate. If a firm's going-concern value exceeds its liquidation value, then the firm generates a "going-concern surplus," and the incurring of this opportunity cost is economically justified.[15] Otherwise, the firm's assets have superior alternative uses, and economic value could be realized by liquidating it.

This comparison between going-concern value and liquidation value implies two cases in which economic value is squandered. The first occurs when a firm's liquidation value exceeds its going-concern value—that is, it has a going-concern deficit—but its managers decide to keep it running anyway, presumably to hold onto their jobs. In that case, the managers have put their interests ahead of the owners' interests. The second case occurs when the firm has a going-concern surplus but it is nonetheless forced to liquidate. Wasteful liquidation could occur because the firm is insolvent and its creditors, knowing that there is not enough value to satisfy all of their claims in full, race against each other to pull the firm apart. Or it could occur because an owner demands a payout of his interest and liquidation is the legal or practical consequence. It is this last possibility that has concerned scholars who have written about capital lock-in.

Of course, if a firm with a going-concern surplus were forced to liquidate, the first choice of the buyers of its assets would not be to put those assets to their best *alternative* uses. Rather, they would want to reassemble the firm, since it was already putting its assets to their best (most profitable) use. But even if a firm with a going-concern surplus could be reassembled after liquidation, some value would be lost in the interim. Most obviously, piecemeal liquidation followed by reassembly would interrupt the firm's operations. A firm will find it difficult to conduct its business while its property undergoes legal (if not physical)

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15. *See* Douglas G. Baird & Edward R. Morrison, *Serial Entrepreneurs and Small Business Bankruptcies*, 105 COLUM. L. REV. 2310, 2330 (2005) (defining "going-concern surplus" as the excess of a firm's value in its current asset configuration over the amount that would be obtained if the firm were shut down and its assets sold off).

fragmentation. As a result, the firm will suffer a temporary loss of operating profits, which will reduce its net present value.[16] And the bidders on the firm's various assets will factor in this temporary loss of operating profits when calculating how much they can pay for those assets and still expect to realize an adequate return on their investments. The assets' combined sales price will therefore be lower than it would be if the assets were sold in a manner that avoided any disruption of operations.

A second potential source of value loss in piecemeal liquidation occurs when a firm has multiple assets with firm-specific value and those assets are acquired by different buyers. An asset has firm-specific value if it is unique and its optimal use requires coordination with other unique assets that the firm owns.[17] Liquidating a firm with firm-specific assets can produce a bilateral-monopoly problem, which arises when there is only one potential buyer and one potential seller of a good or service.[18]

As an illustration of this possibility, imagine an automaker that owns two unique assets: a trademark for a particular model of car and a robot specially designed to assemble that model. We will assume that rebuilding the robot for use on a different car model would be expensive, perhaps prohibitively so. The robot thus has considerable value when used in conjunction with the trademark but little value (perhaps only scrap value) when used otherwise. If the automaker were forced to liquidate, the trademark and robot would ideally be bundled and sold together in a single auction lot, as their combined value is greater than the sum of their values in separate hands. But if for some reason this option were unavailable, then the assets might end up with different new owners. Those new owners would naturally want to reunite the assets, such as by having the one who now owns the robot sell it to the one who now owns the trademark. But the parties would find themselves in a situation of bilateral monopoly, which as characterized by Black's Law Dictionary creates "transactional delays" because "either party can hold out for a better deal without fearing that the other party will turn to a third party."[19] And the anticipation of such transactional delays will reduce the prices that the two assets fetch at their separate auctions, because their would-be buyers will, when

16. To see the point mathematically, imagine the impact on a discounted cash-flow analysis of a firm if the operating profits for the first period, representing the time needed to disassemble and then reassemble the firm, were deleted.

17. *See, e.g.*, Blair, *supra* note 1, at 392; Ricks, *supra* note 6, at 1347.

18. *Bilateral Monopoly*, BLACK'S LAW DICTIONARY (11th ed. 2019).

19. *Id.*

calculating their expected returns on their investments, factor in the profits that will be foregone while the assets are separated.

In addition to uninterrupted operations and coordination between firm-specific assets, another potential contributor to a firm's going-concern surplus is its contractual relationships. Liquidation could threaten a firm's contracts if, as in many bankruptcy proceedings, it results in the dissolution and termination of the legal entity that serves as a party to those contracts. Two types of valuable contract might then be imperiled. The first consists of contracts that capture the value of relationship-specific investments. As an illustration, imagine that our hypothetical automaker does not own the specialized robot mentioned before but rather leases it from its manufacturer. To preserve the value of its investment in the robot, its manufacturer would prefer a lease with a long term, ensuring ongoing joint production and a mutually agreeable division of the resultant surplus. If, however, the robot manufacturer were forced to liquidate in bankruptcy, and in consequence the legal entity housing it dissolved, the lease might terminate because one party to it would have ceased to exist. To be sure, the robot would probably be purchased from the manufacturer's estate by a new owner, who would then seek to enter into a new lease with the automaker.[20] But because we would again have a bilateral monopoly (the new owner is the only possible lessor of the robot, and the automaker is the only possible lessee), negotiations over the lease price might be protracted, with an associated loss of economic profits.[21]

The second type of contract that might contribute to going-concern value is a long-term supply contract that is "in the money." As an illustration, imagine that our hypothetical automaker wishes to lock in its price for aluminum and thus enters into a ten-year contract to buy aluminum at regular intervals at a fixed price. If during the life of the contract the market price of aluminum were to rise above this fixed

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20. Ideally, the automaker would buy the robot at this point. But it might be cash-constrained, which could explain why it was leasing the robot in the first place.

21. Relationship-specific investment could also increase the value of a supplier of labor, i.e., a worker. Such investment could take the form of training that enables the worker to operate a unique piece of machinery owned by his employer. After the training, the worker could hold up the employer by demanding a higher wage, seeking to capture the full benefit of the training for himself. *See* Gary S. Becker, *Investment in Human Capital: A Theoretical Analysis*, 70 J. POL. ECON. 9 (1962). To prevent this, the employer could agree to pay for the training only if the worker enters into a long-term employment contract that locks in a wage rate. If the training is industry-specific but not firm-specific, then the employer might also wish to include a noncompete clause, because judges will not order specific performance of an employment contract against a worker who wishes to quit. *See* RESTATEMENT (SECOND) OF CONTS. § 367 (AM. L. INST. 1981) ("A promise to render personal service will not be specifically enforced.").

price, the contract would then be "in the money" from the perspective of the automaker, whose profits would be greater than they would be if it had to buy aluminum on the spot market. But such profits would be forfeited if dissolution of the legal entity housing the automaker effected the contract's cancellation. In this way, in-the-money supply contracts can contribute to a firm's going-concern value. To be sure, our hypothetical automaker might also have out-of-the-money supply contracts that it would be happy to be able to tear up, in which case cancellation on account of dissolution would destroy value for its counterparties.

It is notable that bankruptcy law provides a mechanism for preserving certain contracts that contribute to the debtor's going-concern value. Under the Bankruptcy Code, the trustee[22] appointed to manage a debtor's estate can (with the permission of the court) selectively assume some of the debtor's executory contracts and unexpired leases while rejecting others.[23] The trustee will normally employ this power to assume only those contracts and leases that are in the money.[24] Moreover, even if the debtor cannot continue to perform its end of the bargain, the trustee can assume an executory contract or lease and then assign it—for a fee, naturally—to a third party.[25] Notably, the trustee has the power to assume an executory contract or lease even if it contains an "ipso facto" clause providing for its termination upon the debtor's bankruptcy.[26] Contractual prohibitions on assignment are similarly unenforceable, with state contract law giving way to federal law.[27] By these means, bankruptcy law seeks to preserve the value the debtor derives from certain of its profitable contracts even when the parties have bargained for something else.

To summarize, we can say that liquidation can destroy a firm's going-concern value by two main mechanisms. First, it can disrupt operations, including by interrupting coordination of firm-specific assets. And second, it can deprive the firm of value from profitable long-term contracts. With these mechanisms of value destruction in mind, we now consider the prior scholarly literature on the question whether,

22. If the case proceeds under Chapter 11, contemplating reorganization of the debtor rather than liquidation, the debtor's managers will serve in lieu of the trustee, acting on behalf of the "debtor in possession" of its own estate. 11 U.S.C. § 1107.

23. *Id.* § 365(a).

24. Rejection gives the counterparty a damages claim for breach, but the claim is treated as if it arose before the bankruptcy filing and therefore will typically be worth, on account of the debtor's insolvency, only a fraction of its face value. *Id.* § 365(g)(1).

25. *Id.* § 365(f)(1).

26. *Id.* § 365(e).

27. *Id.* § 365(f)(1).

and to what degree, the corporation and the partnership preserve going-concern value when equity investors wish to pull out.

B. The Lock-in Literature

The first important scholarly work to suggest that legal entities play a role in preserving going-concern value in business firms was Henry Hansmann and Reinier Kraakman's groundbreaking 2000 article *The Essential Role of Organizational Law*.[28] The article argues that the essential role of business entities such as corporations and partnerships is to introduce a legal partition between a firm's assets and the personal debts of its owners.[29] Such partitioning is "essential" because many firms would find it prohibitively expensive to achieve by contract alone.[30] Both the partnership and the corporation serve this partitioning role by granting the firm's creditors the first claim to the firm's assets, thereby denying personal creditors any recovery from those assets unless the firm's debts have first been paid in full.[31] In addition, the corporation (and other "strong-form" entities) goes a step further by adding a rule of "liquidation protection," which disables each of a firm's owners and his personal creditors from unilaterally withdrawing his share of the firm's assets.[32] Without such liquidation protection, each owner and his personal creditors could effectively demand piecemeal liquidation or division of the firm's assets, which would imperil going-concern value.[33]

The next key paper on the subject of business entities and going-concern value was Margaret Blair's seminal 2003 article on capital lock-in.[34] The article's thesis is that "demand for the corporate form surged in the mid-nineteenth century United States because this form uniquely facilitated the establishment of lasting enterprises that could accumulate substantial enterprise-specific physical assets, and form extensive specialized organizational structures."[35] This thesis can be understood as comprising two distinct claims. The first is an historical claim, namely that the corporation's strong rule of capital lock-in made the corporate form especially useful to modern industrial firms. And the second is an economic claim: that capital lock-in protects a specific

28. Hansmann & Kraakman, *supra* note 3.
29. *Id.* at 390.
30. *Id.* at 407–12.
31. *Id.* at 395.
32. *Id.* at 394, 434–35.
33. *Id.* at 403–04.
34. Blair, *supra* note 1.
35. *Id.* at 413.

component of going-concern value—namely, value from firm-specific (or "enterprise-specific") assets.[36] As described by Blair, a business owner could hold up his co-owners if he enjoyed the power to order a general division of the firm's assets or demand the return of a firm-specific asset he had contributed to it.[37] By locking in capital, the corporation denies such powers to shareholders (and their successors, such as heirs).[38]

In 2006, Hansmann and Kraakman—now joined by me as their coauthor—published the article *Law and the Rise of the Firm*, which describes the historical development of asset partitioning in business organizations.[39] Because the article considers a broad swath of economic and legal history, spanning from ancient Rome to the modern United States, by necessity it offers a less-detailed analysis of the Industrial Revolution than Blair provided in *Locking in Capital*. Its thesis regarding that period is nonetheless consistent with Blair's, as it emphasizes the role played by "strong entity shielding"—which includes liquidation protection—in making the corporate form attractive to large American businesses during the nineteenth century.[40] Once again, the primary economic function of liquidation protection is identified as going-concern protection, with associated benefits in terms of scale economies that are realized when a firm can bring on new investors without concern that they or their personal creditors will use withdrawal threats to hold up the firm.[41]

The idea that the corporation's strong rule of capital lock-in protects going-concern value has been widely accepted and cited. At the same time, it has led some scholars to question whether the business corporation was—at the time of its emergence in the nineteenth century—unique in protecting such value, or unique only in its means for doing so.[42] One such scholar was Larry Ribstein, a national expert

36. *Id.* at 402.

37. *Id.* at 401–02.

38. "Lock in" as used by Blair and "liquidation protection" as used by Hansmann and Kraakman are largely synonymous, as both refer to rules preventing owners and their personal creditors from withdrawing assets representing the owner's equity interest in the firm. *See* Blair, *supra* note 1, at 389; Hansmann & Kraakman, *supra* note 3, at 434. Blair, *supra* note 1, at 392, also used "lock in" to refer to withdrawal restrictions on the heirs of owners, whom Hansmann and Kraakman did not separately address, implicitly grouping them with personal creditors.

39. Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1333 (2006).

40. *Id.* at 1394.

41. *Id.* at 1349 n.38.

42. In addition to the articles by Ribstein and Ricks discussed below, another important article in this category is by John Morley, who showed that business organizers historically had another limited-liability option available to them: the business trust. John Morley, *The Common-Law Corporation: The Power of the Trust in Anglo-American Business History*, 116 COLUM. L. REV.

on partnership law. In his 2005 article *Why Corporations?*,[43] Ribstein noted that partners have always been able to suspend their payout rights by agreeing to a partnership for a term or a specific undertaking.[44] Although drafting around a default rule entails expense, Ribstein observed that "lawyers have considerable experience with continuation agreements in partnerships."[45] Ribstein further argued that partnerships also enjoy protection against heirs, as the partnership agreement can provide for cash payouts over time of the interests of retiring or deceased partners, and a partner's heirs have no interest in specific partnership property.[46]

More recently, Morgan Ricks has shown that partnership law employs mechanisms for locking in specialized assets even when the partners have not agreed to suspend their individual payout rights. In his innovative 2017 article *Organizational Law as Commitment Device*,[47] Ricks identified another "essential" function of entity law: to permit "property relinquishment," whereby a firm's owners surrender any property interests they might hold in specific business assets, in exchange for which they receive an interest in the firm's undifferentiated assets as a whole.[48] As described by Ricks, property relinquishment "practically eliminates the ability of co-owners (and their successors/heirs) to defect with individual business assets."[49]

Property relinquishment is clearly a feature of the business corporation, which has always been recognized as a legal entity distinct from its shareholders. In other words, it is well established that the corporation, not its shareholders, owns the property of the underlying

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2145 (2016). Morley argued that, by the nineteenth century if not before, business organizers could achieve most of the features of a corporation—including limited liability, entity shielding, tradable shares, and capital lock-in—by use of a trust, which held the property of a partnership or other unincorporated business association. The arrangement evidently fell into disuse by the early twentieth century, supplanted by the corporation. *Id.* at 2179.

43. Larry E. Ribstein, *Why Corporations?*, 1 BERKELEY BUS. L.J. 183 (2005).

44. *Id.* at 194. The point had been acknowledged by Hansmann and Kraakman, whose argument was that organizational law was needed to make such an agreement binding on the partners' personal creditors. Hansmann & Kraakman, *supra* note 3, at 412. It had also been acknowledged by Blair, who further noted that a common-law partnership, even if for a term or a specific undertaking, would nonetheless automatically dissolve if "a partner died, became insane, or went bankrupt." Blair, *supra* note 1, at 410.

45. Ribstein, *supra* note 43, at 194.

46. *Id.* at 194–95. Hansmann and Kraakman recognized that partnership law had developed some common-law mechanisms for providing liquidation protection. In particular, they noted that "courts are sensitive to the desirability of preserving going-concern value, and for this reason will generally decree foreclosure on an interest in a partnership [on behalf of a partner's personal creditor] only as a last resort." Hansmann & Kraakman, *supra* note 3, at 404 n.25.

47. Ricks, *supra* note 6.

48. *Id.* at 1351.

49. *Id.* at 1306.

business. But Ricks showed that property relinquishment is also an attribute of the common-law partnership and indeed has been so since at least the nineteenth century, even though partnerships were not then considered distinct legal entities.[50] Therefore, courts have consistently held that a withdrawing partner enjoys no power to demand a partitioning or piecemeal liquidation of partnership property.[51] Rather, nineteenth-century courts ruled that dissolution of a partnership upon a partner's withdrawal gave each partner the right to demand a sale of the whole firm, intact and without interruption of its operations.[52] As described by Ricks, "the *partnership* was 'dissolved' in such cases, but the *business* continued."[53] The rule remains in force today.[54] Moreover, if a partner died or became a debtor in bankruptcy, nineteenth-century courts held that the rights of his heirs or creditors were no greater than his own: they could seek a sale of the whole firm followed by a cash payout but not a division of its assets.[55] The benefits of such a "forced sale" are conspicuous, as the sale both assigns a value to the departing partner's interest and raises the cash needed to pay it out.[56] But Ricks also emphasized that, in combination with the cash-only payout rule, the forced-sale option preserves the underlying business's particular asset configuration when it is worth preserving.[57]

In reviewing the literature to date on the relationship between business entities and going-concern value, we see that each article either treats going-concern value as a uniform concept (Hansmann and

50. *Id.* at 1327–28. Partnership law achieves property relinquishment through three features: the "disgorgement" feature, whereby a partnership can recover all profits from a productive asset that one partner has diverted from the business; the "in rem" feature, whereby a knowing purchaser of a partnership asset that was sold to him without partnership authorization may use it only for partnership purposes; and the "title consolidation" feature, whereby partners surrender their claims to specific partnership assets not only for the life of the partnership but also through dissolution, so that none can force a partitioning and in-kind distribution of the assets upon the partnership's termination. *Id.* at 1331–38.

51. *Id.* at 1308.

52. *Id.* at 1337–38.

53. *Id.*

54. CHRISTINE HURT, D. GORDON SMITH, ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP § 7.11[B] (2d ed. 2019).

55. *Id.*

56. In upholding a partner's right to insist upon a sale and cash payouts of partner interests upon his partnership's dissolution, the Wisconsin court in the seminal case of *Dreifuerst v. Dreifuerst* cited both of these functions, as well the proposition that the partnership assets might be worth more intact than separated. 280 N.W.2d 335, 338–39 (Wis. Ct. App. 1979) (noting that "the assets of the partnership as a whole may be worth more than the assets once divided up," and that a sale is the best way to determine the "true fair market value of the assets").

57. "[T]raditional partnership law allowed venturers to commit to more durable asset configurations than would have been possible (or would today be possible) through contracting alone, thereby supporting the creation of going-concern value." Ricks, *supra* note 6, at 1308.

Kraakman, Ribstein) or addresses just one component of such value, effectively equating it with going-concern value in toto (Blair, who focused on firm-specific assets, and Ricks, who similarly focused on the partnership's particular asset configuration). The authors' choices in this regard are understandable, as their respective theses required that they devote the space available to them to detailed analyses of the legal and economic structure of business entities and, in several articles, to legal history. The authors thus implicitly left to future scholarship the task of expanding upon their analyses by considering whether, and by what mechanisms, the corporation and the partnership protect each of the distinct components of going-concern value, which—as I have described—include uninterrupted operations, assets with firm-specific value, and profitable contracts. I take up that task here, beginning with the corporation.

C. Going-Concern Value and the Corporation

Unless the charter provides otherwise, a corporation's capital is entrusted to the board of directors, and shareholders have no power to insist upon its return. The board enjoys the exclusive power to declare dividends, normally payable only to the extent that the firm has a surplus. And a shareholder's capital—reflecting the full value of the shareholder's equity interest in the corporation—can normally be returned to him only in one of three ways: a share buyback, the exercise of appraisal rights in connection with a merger, or dissolution of the corporation itself. Each such action must be initiated by the board (and then ratified, in the case of dissolution and some mergers, by holders of a majority of shares).[58] Thus, the corporation really does lock in capital, and the board holds the key.

Of the three methods for returning capital to shareholders, only dissolution could, in theory, present a substantial threat to each of the components of going-concern value. Dissolution followed by termination would normally cancel the corporation's contracts because the corporation as party to those contracts would no longer exist. And dissolution might disrupt the firm's operations and fragment its asset holdings, unless—as is often the case—it is the last step in a transaction whereby the corporation sells its business intact and distributes the proceeds to the shareholders.

In practice, however, there is no reason for a board of directors to authorize dissolution of their corporation while it has a going-concern

58. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 160, 251, 273 (2021) (covering share buybacks, mergers, and dissolutions, respectively).

surplus. This is true regardless of whether the directors are dedicated to serving shareholder interests or just their own. If they are loyal to the shareholders, they will avoid value-destroying dissolution, which by definition injures the shareholders collectively. And if they are loyal only to themselves, they will avoid dissolution regardless of whether the corporation has a going-concern surplus, simply to preserve their positions. Indeed, as noted previously, the real hazard is not that the directors will authorize dissolution when the firm has a going-concern surplus, but rather that they will fail to initiate dissolution when the firm has a going-concern deficit, a situation in which their personal interests directly oppose those of the shareholders.

Share buybacks, by contrast, are the capital-return method that presents the least threat to going-concern value, both theoretically and in practice. Buybacks do not cancel the corporation's contracts (unless for some reason the contracts say they do), nor is there any reason they should disrupt its operations. In theory, the directors could authorize a distribution of real assets rather than cash to purchase shares, but it is hard to see why they would want to do so, especially if the assets have firm-specific value, as the directors would then harm shareholders collectively while imperiling the firm they presumably enjoy directing. For these reasons, share buybacks are almost always for cash. Selfish directors do not want to authorize even these, preferring to retain control over the firm's money, while faithful directors will authorize them only if the firm has a healthy equity cushion and the board is unaware of profitable projects in which to invest its cash.

Finally, merger-linked appraisal rights should also normally pose no threat to going-concern surplus, although exceptional scenarios can be imagined. The board must authorize any merger that would trigger appraisal rights, and there is little reason for it to do so when the exercise of those rights is likely to disrupt operations or force liquidation of valuable assets. Again, faithful directors will not deliberately imperil a going-concern surplus, and self-interested ones will not put their positions at risk.

The structure of appraisal rights further reduces the likelihood that their exercise will undermine the merged firm's going-concern value. The rights are payable in cash, and the post-merger firm will normally have multiple options for raising that cash (tapping reserves, taking on new debt, issuing new shares, etc.). Moreover, shareholders waive their appraisal rights by voting for a merger,[59] and many mergers cannot be consummated unless ratified by holders of a majority of

59. *Id.* tit. 8, § 262(a).

shares.[60] In combination, these rules place an upper bound on the number of shares that the post-merger firm could be forced to buy back. Finally, if the board has reason to fear that shareholders will exercise their appraisal rights en masse, it can insist on a higher merger price as a condition of the deal, which will discourage shareholders from exercising their appraisal rights since by doing so they forgo the merger consideration they would have otherwise received.[61]

For all these reasons, the likelihood that the exercise of merger-linked appraisal rights will significantly disrupt a corporation's operations or force it to sell off valuable assets is exceedingly small. Such consequences are not unimaginable, but they will occur only when the board has badly underestimated the level of shareholder discontent with the merger and yet that level is nonetheless insufficient to cause holders of a majority of shares to vote against it. Such a "sweet spot" level of underestimated shareholder dissatisfaction appears to be an exceedingly rare occurrence. This is not to say that appraisal rights cannot be costly in other ways: the recent wave of "appraisal arbitrage" was a nuisance to many firms, imposing transaction costs and in some cases forcing firms to pay more to shareholders than those shareholders would have received had they acceded to the merger.[62] But such costs did not derive from damage to, or inflict damage upon, the sources of going-concern value.

To this point, I have implicitly assumed a board of directors that is not dominated by a controlling shareholder. This is a realistic assumption for publicly traded corporations in the United States, most of whose shares are widely held. But of course some corporations have controlling shareholders whose interests with respect to capital-returning transactions could differ from those of an independent board or of minority shareholders. The corporate form does not lock in the capital of controlling shareholders, who can dictate share-buyback and merger policy to the board, and who typically hold enough shares that they can unilaterally ratify fundamental transactions such as mergers and dissolutions.

Yet while controlling shareholders have the power to withdraw capital in a manner that damages going-concern value, they have little incentive to do so, since they would bear the lion's share of the resulting losses, being the largest residual claimants to that value. Therefore, if a corporation has a going-concern surplus, its controlling shareholder is

60. *Id.* tit. 8, § 251(c).

61. *See id.* tit. 8, § 262(h), (*l*).

62. *See* Wei Jiang, Tao Lio & Randall Thomas, *The Long Rise and Quick Fall of Appraisal Arbitrage*, 100 B.U. L. REV. 2133, 2144 (2020).

unlikely to effect a dissolution or merger that would imperil the main components of that surplus. He would rather cash out the minority shareholders and keep the firm for himself, an act that might be opportunistic (the price paid for minority shares might be inadequate) but that does not reduce the firm's going-concern value. As for a buyback of his own shares, the controlling shareholder's fiduciary duties to the minority make it difficult for him to cause the corporation to do this to their exclusion,[63] and if he must include them he has no reason to buy back shares in a way that imperils going-concern surplus, since he will, again, be the primary victim.

In sum, we see that the corporation does generally lock in capital to the extent necessary to protect each of the components of going-concern value. We now turn to the partnership, where unilateral withdrawal and payout rights make the analysis of going-concern protection more complicated.

D. Real Capital Lock-in in the Partnership

Like corporations, partnerships can make periodic distributions of profits, analogous to dividends. Such distributions typically must be authorized by a majority of partners, whose financial interests will normally lead them to approve only those distributions that do not undermine their firm's going-concern surplus. Their incentives in this regard thus parallel those of a majority shareholder. By contrast, an individual partner might exercise his payout right even if doing so decreases the firm's going-concern surplus, since he knows that much of the resulting loss will be borne by the other partners. Therefore, the question of interest is whether partnership law circumscribes the payout right in a manner that prevents its exercise from injuring the remaining partners through impairment of the various sources of going-concern value.

1. The Consequences of Partner Withdrawal

Unless the partnership agreement states otherwise, a partner can obtain a full payout of his capital only if he withdraws from the partnership. And withdrawal has two additional consequences: it

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63. *See, e.g.*, Donahue v. Rodd Electrotype Co. of New Eng., Inc., 328 N.E.2d 505, 593 (Mass. 1975) (holding that shareholders in a close corporation owe each other the same fiduciary duty that partners owe to one another in a partnership); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 719 (Del. 1971) (holding that the parent corporation owes a fiduciary duty to its subsidiary in dealings between them).

dissociates the partner from the business, and it *dissolves* the partnership itself. This was true in the common-law partnership of the nineteenth century, and it remains true under the Revised Uniform Partnership Act of 1997 ("RUPA"), which has been adopted by thirty-nine states.[64]

"Dissociation" refers to the cessation of a partner's general powers and duties with respect to the partnership. A partner who dissociates loses his general authority to act as the partnership's agent,[65] and he can no longer participate in the management and conduct of the business, except perhaps for purposes of winding it up.[66] He also is no longer generally liable for new partnership debts,[67] nor must he continue to refrain from competing with the partnership.[68] The RUPA explicitly uses the term "dissociation" to refer to these consequences of withdrawal. Withdrawal also has these consequences under the Uniform Partnership Act of 1914 ("UPA"),[69] just as it did under the pre-statutory common law, even though the UPA and most of the older case law does not explicitly distinguish between dissociation (a consequence for the partner) and dissolution (a consequence for the partnership).

The second consequence of a partner's withdrawal, dissolution, does not mean what it sounds like. A partnership that dissolves does not break apart and disappear like a sugar cube dissolving in water. Rather, it enters into a winding-up period of indefinite length before reaching its end point, "termination."[70] For our purposes, the most important consequence of dissolution is that it gives each partner—

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64. To date, the states that have not enacted it are Georgia, Indiana, Louisiana, Massachusetts, Michigan, Missouri, New Hampshire, New York, North Carolina, Rhode Island, and South Carolina. Most of these remaining states use the Uniform Partnership Act of 1914 ("UPA").

65. REVISED UNIF. P'SHIP ACT § 603 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1997).

66. *Id.* §§ 603, 802(c).

67. *Id.* § 703. An exception may apply if the debt was incurred before the partnership finished winding up and the creditor was not on notice that the partner had withdrawn. *Id.* § 703(b).

68. *Id.* § 603(b)(2).

69. UNIF. P'SHIP ACT § 33 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1914).

70. REVISED UNIF. P'SHIP ACT § 802(a); UNIF. P'SHIP ACT § 30. Before the enactment of the RUPA, the winding-up period could be indefinite, meaning that the remaining partners often could continue operating the business for as long as they wished. *See* HURT ET AL., *supra* note 54, at § 7.01[b] (observing that, under the UPA, "[it] is . . . more accurate to characterize the partnership business as continuing indefinitely, unless the partners decide to wind it up, than to regard winding up of the business as a necessary or even usual consequence of dissolution"). The RUPA, by contrast, permits a partner to dissociate without thereby causing the partnership's dissolution. REVISED UNIF. P'SHIP ACT § 601. Given this possibility, the RUPA further specifies that, when dissolution does occur, the subsequent winding-up activities must be for the sole purpose of bringing the partnership to termination. *Id.* § 802(a).

including the withdrawing one, unless he withdrew wrongfully[71]—the right to demand a sale of the entire business, whole and intact, unless the partnership agreement states otherwise.[72] As noted earlier, this right works naturally in conjunction with the payout requirement because it provides a mechanism for both raising cash and determining how much of that cash the departing partner is owed.[73] Morgan Ricks called this the "forced sale" right because it trumps any personal preference the other partners might have to partition the firm's property or employ a different valuation method.[74]

The forced-sale right prevents dissolution from automatically shutting down the partnership's underlying business. If they wish, the non-withdrawing partners can bid at the auction for the business and continue to operate it if they prevail. And they usually will prevail, as their inside knowledge of the business gives them an advantage in appraising it.[75] In consequence, the business of a dissolved partnership can, and often does, continue in the hands of the same owners (minus one), an option that Ricks showed was available in the nineteenth century just as it is today.[76]

The third consequence of withdrawal is the one that has been the focus of the scholarship on going-concern protection: the payout right. Unless the partners have agreed otherwise, the withdrawing partner is entitled to a payment equal to the value of his partnership interest. Importantly, the default rule is that this value is payable in cash rather than through a division and in-kind distribution of partnership property. This is true both under the RUPA and under the UPA, which codified the common law.[77]

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71. Under the RUPA, a partner's dissociation from a partnership that has not yet completed an agreed-upon term or specified undertaking does not dissolve the partnership unless a majority of the remaining partners votes for dissolution. *Id.* § 801(2)(i).

72. *See* Dreifuerst v. Dreifuerst, 280 N.W.2d 335, 339 (Wis. Ct. App. 1979) (applying Wisconsin's version of the UPA); Ricks, *supra* note 6, at 1337 (describing the forced-sale right under nineteenth-century common law).

73. *See Dreifuerst,* 280 N.W. 2d at 335, 339 ("[A] sale is the best means of determining the true fair market value of the assets.").

74. Ricks, *supra* note 6, at 1339.

75. *See* ALAN R. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP 489–90 (1968) ("Theoretically, liquidation [upon dissolution] calls for a sale of partnership property to strangers, payment of debts, and division of proceeds among the partners. Factually, the most logical buyers are often the remaining partners.").

76. *See* Ricks, *supra* note 6, at 1337–38; Alan R. Bromberg, *Partnership Dissolution–Causes, Consequences, and Cures*, 43 TEX. L. REV. 631, 631–32 (1965).

77. REVISED UNIF. P'SHIP ACT §§ 701(e), 807(a) (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1997); UNIF. P'SHIP ACT § 38(1) (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1914); Ricks, *supra* note 6, at 1337.

As the literature on going-concern value and business entities recognizes, voluntary withdrawal is not the only event that might separate a partner from his partnership. He might die, an eventuality emphasized by Blair,[78] or he might become a debtor in bankruptcy, a risk emphasized by Hansmann and Kraakman.[79] Death naturally dissociates a partner from the partnership, and it has been established for more than a century that personal bankruptcy does as well. In either case, the partner's estate has the right to a cash payout of his interest.[80] On the other hand, the RUPA provides that a partner's dissociation by death or bankruptcy does not dissolve the partnership,[81] the implication being that his heirs and personal creditors are not entitled to force a sale of the business. Rather, the partnership must purchase the dissociated partner's interest for cash at a price equal to the amount that would have been distributed if "the assets of the partnership were sold at a price equal to the greater of the liquidation value or [sic[82]] the value based on a sale of the entire business as a going concern without the dissociated partner."[83] In other words, under the RUPA the successors have a right to a cash buyout of the partner's interest at a price determined by a hypothetical sale rather than an actual sale. In this way, the RUPA distinguishes between events of dissociation that also cause dissolution (voluntary withdrawal, assuming a partnership at will) and events of dissociation that do *not* also cause dissolution (death or personal bankruptcy), with different implications for the payout right.

The question of buyout versus forced sale in case of a partner's death or bankruptcy is murkier under the UPA, which, as noted, conflates dissolution and dissociation.[84] But courts applying the UPA have traditionally been reluctant to force a sale on behalf of a partner's estate when the remaining partners are opposed; instead, judges have normally ordered the partnership to purchase the partner's interest from his estate, the same approach prescribed by the RUPA.[85] This

78. Blair, *supra* note 1, at 420.

79. Hansmann & Kraakman, *supra* note 3, at 390 ("The truly essential aspect of asset partitioning is, in effect, the reverse of limited liability—namely, the shielding of the assets of the entity from claims of the creditors of the entity's owners or managers.").

80. REVISED UNIF. P'SHIP ACT §§ 601(7)(i), 701(b); UNIF. P'SHIP ACT §§ 31(4), 31(5), 38.

81. REVISED UNIF. P'SHIP ACT §§ 601(6), 601(7), 801.

82. The term "the greater of" designates a member of a two-member set and therefore cannot refer to the set "X or Y," which has only one member, consisting of either of two alternatives. Compare "John is the taller of two brothers" (makes sense) with "John is the taller of one brother or the other" (doesn't sound right). The "or" in this excerpt from the RUPA should be an "and."

83. REVISED UNIF. P'SHIP ACT § 701(b).

84. HURT ET AL., *supra* note 54, § 7.11[B][1].

85. *See id.* § 7.11[F] (collecting cases).

"forced buyout" approach was evidently something of a twentieth-century innovation; according to Ricks, nineteenth-century courts typically ordered a going-concern sale of the partnership business upon the request of a partner's estate, at least upon a showing of good cause.[86]

2. Protection of Ongoing Operations and Firm-Specific Assets

We will now consider the implications of the three legal consequences of partner withdrawal—dissociation, dissolution, and payout—for each of the main components of going-concern value. The first two components—uninterrupted operations and value from firm-specific assets—generally go together, as piecemeal liquidation directly threatens both by fragmenting the firm's property.

A partner's dissociation need not, in itself, bring the partnership's operations to a halt or split up its assets. As noted, the remaining partners can continue to operate the firm. While the departing partner's labor might have been of great value to the firm, there is nothing entity law can do to retain it, since labor contracts are not subject to specific performance.[87] In other words, there is no difference in this regard between a partnership and a corporation, whose managers similarly might quit at any time.

Dissolution, in turn, also need not interrupt business operations, because its main implication is that the firm enters a winding-up period that ends when the firm is sold and the cash proceeds are divided. And any partner can, as described above, insist that the firm be sold intact. To be sure, piecemeal liquidation could occur instead, but this will happen only if all partners agree to it, which they will rationally do only if the firm lacks a going-concern surplus. (Conversely, if the firm is insolvent, with debts exceeding the value of its assets, then bankruptcy law rather than partnership law will probably decide its fate, another regard in which the partnership is not different from the corporation.)

Finally, the payout right also presents little threat of disruption or fragmentation, since it is payable in cash at the demand of any partner, and the remaining partners can employ any available option for raising that cash. Thus, they might find it in the partnership's bank account, or in their own. Or they might arrange for the partnership to borrow it, or raise it by bringing on a replacement partner.[88] Each of

86. *See* Ricks, *supra* note 6, at 1339.

87. *See* RESTATEMENT (SECOND) OF CONTS. § 367 (AM. L. INST. 1981).

88. It might seem that the partnership would have to be fully solvent to raise the needed cash through borrowing or issuing a new equity interest. But note that the withdrawing investor's payout entitlement shrinks as the firm approaches insolvency, as it is a claim on *net* assets. So the

these options remains available even if the partner's withdrawal triggers a forced sale, because whoever wins the auction (and it may be the remaining partners) can then decide whether to make the payout from the partnership's existing cash balance, from newly raised capital, or from personal funds. Once again, the remaining partners or their successors can preserve the business intact if doing so is efficient.

It is important to observe that cash itself can never have firm-specific value and hence that a cash payout right cannot directly threaten going-concern value derived from firm-specific assets. By definition, firm-specific assets are unique, whereas cash is the ultimate commodity, with all units being perfectly fungible. Recall that an owner's power to hold up a firm by threatening to withdraw firm-specific assets arises due to the problem of bilateral monopoly, wherein each party values something that only the other can provide. So, for example, imagine that a withdrawing partner was able to remove from his partnership a unique robot worth $100,000 to the partnership but only $20,000 (its scrap value) to anyone else. Naturally, the partnership would subsequently want to buy the robot back from the ex-partner for any price up to $100,000, while the ex-partner would want to sell it back to the partnership for any price above $20,000. A negotiation would thus ensue, which, given such a wide bargaining space, might involve prolonged bargaining, walk-away threats, stonewalling, and so on. Meanwhile, the partnership will lose operating profits as the robot lies idle.

If, however, the departing partner is entitled only to remove cash, there is no resulting bilateral monopoly. From the partnership's perspective, the value of the cash in his hands is the same as the value of an equivalent amount of cash held by anyone else. Therefore, if the partnership needs to borrow to replenish its cash stores, it will have no special reason to seek the loan from the ex-partner rather than from other potential lenders. In the market for cash loans, the market interest rate is the price and everyone is a price taker. Since the asset is perfectly fungible, there is no bilateral monopoly, no holdup threat that will interfere with reassembly of the firm to its original scope, and, hence, no threat to going-concern value.

To be sure, one can imagine a scenario in which the three legal consequences of a partner's withdrawal might present a threat to the partnership's particular asset configuration. For example, a withdrawing partner might threaten to force a sale of the business

burden from the payout right does not increase, at least linearly, as the firm's degree of solvency decreases. In this way, withdrawal of equity contrasts with acceleration of a loan, as a lender's payment entitlement is fixed and therefore does not adjust in accommodation of the borrower's degree of solvency.

under conditions in which the remaining partners desire to remain in control of the firm but fear they would be outbid by outsiders at an auction.[89] The withdrawing partner could then hold up the others for a cash payment that exceeds the true value of his interest, the payment representing, in effect, the purchase price of his right to force a sale. In that scenario, the remaining partners might be willing to sell off some of their firm's property to raise the needed cash. Some disruption of operations, loss of scale economies, or even separation of firm-specific assets might result.[90]

But how realistic is this scenario? Notably, it requires the remaining partners to fear being outbid at an auction for their firm. Yet we know that partners are typically in the best position to appraise the partnership accurately due to their inside knowledge; anyone who outbids them is likely to suffer buyer's remorse. Moreover, the remaining partners would normally have a great deal of flexibility in how they raise the cash necessary to pay off the partner who is holding them up. Again, options include drawing on the firm's cash reserves, tapping credit lines, and borrowing from new lenders to whom the partners might offer the partnership's assets as collateral. In the unlikely event that no such source is availing, the partners could raise cash by selling partnership property that lacks firm-specific value, for which they could obtain a market price.[91]

Finally, even if the remaining partners were forced as a last resort to raise cash by selling property with firm-specific value, they

89. The scenario described requires deliberate withdrawal by the partner rather than dissociation on account of his death or personal bankruptcy, since his heirs and personal creditors have no forced-sale power under the RUPA, and their power to insist upon a sale of the firm even under common law was more limited than that of the partner himself.

90. Hansmann and Kraakman described a somewhat similar holdup scenario. *See* Hansmann & Kraakman, *supra* note 3, at 403–04:

> [A] personal creditor [of an owner] with a right to foreclose on firm assets might well threaten to exercise that right and destroy substantial going concern value—even if he could realize little or nothing thereby because the firm lacks sufficient net worth—simply to hold up the firm (or its owners or creditors) for a sum larger than his claim on the firm would receive if he actually foreclosed.

In seeming recognition of this hazard, the RUPA denies personal creditors the power to dissolve the partnership or force a sale; it instead empowers courts to issue a partner's personal creditor a charging order against the partner's transferable interest. REVISED UNIF. P'SHIP ACT § 504 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1997). On the other hand, if the partner is bankrupt, his bankruptcy trustee can force the partnership to purchase his interest for cash at a price determined by a third-party appraiser, a power that introduces a holdup hazard to the extent of the costs to the partnership of raising the needed cash and the possibility that the appraiser will overvalue the interest. *Id.* § 701.

91. To prevent any disruption of production or loss of scale economies, the partnership could arrange to lease the property back.

could still preserve that value by insisting that the buyer lease the property back to the partnership on terms that permitted it to capture the full associated surplus. And there is no reason to suspect that a deal on such terms would be difficult to arrange as long as there were multiple potential buyers of the property and the partnership were willing to offer the buyer/lessor a normal rate of return on his investment. Put another way, a forced sale of a firm-specific asset does not create a bilateral-monopoly problem (as forced partitioning does), since the partnership can make leaseback a condition of the sale.

Of course, there may be situations in which one partner withdraws because he wants to force a sale that will enable him to buy out the others and take the whole business for himself. The famous California case of *Page v. Page* appears to have involved such a scheme.[92] In that situation, however, one partner forces a sale not to hold up the others but rather to squeeze them out. Control over the partnership is at stake but its going-concern value is not at risk.

These observations confirm Ricks's argument that American partnership law, in both its common-law and statutory manifestations, provides a significant degree of protection to the firm's particular asset configuration when a partner withdraws. Dissociation, dissolution, and payout, neither individually nor in combination, appear likely to fragment a partnership's property or interrupt its operations unless such consequences would be efficient.

3. Contract Protection Upon Partner Withdrawal

It remains to consider whether any of the legal consequences of a partner's withdrawal might threaten going-concern surplus arising from a partnership's contracts. It would be natural to assume that a partnership's contracts terminate when the partnership does, as a contract cannot bind a person who has ceased to exist. But this assumption would be incorrect. At common law, a partnership was not considered a distinct legal entity,[93] and its partners were thus deemed to be the real parties to its side of the contract.[94] Therefore, unless the

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92. 359 P.2d 41 (Cal. 1961).

93. HURT ET AL., *supra* note 54, § 1.03[B].

94. A 1911 treatise explained this principle as follows: "As the law does not recognize the partnership as a legal entity apart from its members, a partnership as such cannot be a party to a contract. . . . [T]he contracts of a partnership are the contracts of the individual partners jointly." EUGENE ALLEN GILMORE, HANDBOOK ON THE LAW OF PARTNERSHIP, INCLUDING LIMITED PARTNERSHIPS § 69 (1911).

contracts explicitly provided otherwise,[95] a partnership's contracts survived the partnership itself, since the real parties to them remained in existence.[96] Notably, this rule meant that the partnership's contracts survived not just the partnership's dissolution but also its termination, a consequence that effectively prevented partners (or their successors) from using the threat of withdrawal to hold up the partnership to the extent of the surplus from those contracts.[97]

During the twentieth century, the notion that a partnership is merely an aggregation of its partners gradually gave way to the view that it is a distinct legal entity. The UPA shifted the partnership toward legal-entity status by allowing it to hold property in its own right and by specifying that partners are agents of the partnership rather than of each other.[98] And the RUPA seemingly completed the transformation by declaring that a partnership "is an entity distinct from its partners."[99] Such developments might seem to have undercut the reasoning behind the common-law rule that a partnership's contracts survive the partnership's dissolution and termination. Yet courts have,

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95. In this sense, then, partnership law's treatment of executory contracts is different from that of bankruptcy law, which, as noted above, disregards ipso facto clauses that purport to terminate executory contracts when either party files for bankruptcy.

In discussing the problem of asset fragmentation, Morgan Ricks made the intriguing observation that "organizational law and business bankruptcy law enjoy a deep conceptual symmetry," as "organizational law prevents business co-owners from inefficiently dismantling asset configurations," while bankruptcy law "prevents business *creditors*" from doing the same. Ricks, *supra* note 6, at 1346. A parallel point can be made with respect to executory contracts: bankruptcy law protects their value against debt-collection efforts by the firm's creditors, whereas partnership law protects their value against efforts by a partner, his heirs, or his personal creditors to achieve a payout of his partnership interest. In both cases, however, there is an important difference, as bankruptcy is a mandatory regime, whereas the elements of partnership law that protect both valuable asset configurations and profitable contracts may be varied freely by contract.

96. *See* Asbestos Mfg. & Supply Co. v. Lenning-Rapple Eng'g Co., 146 P. 188, 189 (Cal. Dist. Ct. App. 1914) ("[S]uch dissolution [of a partnership] does not ordinarily absolve third persons from their contractual obligations to the firm." (citation omitted)); Horst v. Roehm, 84 F. 565, 568 (C.C.E.D. Pa. 1898) (rejecting the notion that "any dissolution of a commercial partnership, accompanied by a division of its executory contracts, would work their extinguishment," and holding that the contractual rights of the partners "continue to be enforceable, though only by action . . . in the name of all").

97. If a partner merely dissociates (and perhaps receives a cash payment) but there is no consequent dissolution of the partnership, the rule again is that the partnership's contracts are unaffected unless they provide otherwise. Since the partnership does not terminate, it continues as a party to its contracts. Indeed, the dissociated partner's liability on those contracts also continues unless the counterparty agrees to release him; dissociation removes his liability for subsequent partnership obligations but not for past ones. REVISED UNIF. P'SHIP ACT § 703 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1997); UNIF. P'SHIP ACT § 36 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1914).

98. UNIF. P'SHIP ACT §§ 8–9.

99. REVISED UNIF. P'SHIP ACT § 201(a).

once again, come to the rescue of going-concern value, as they have preserved the contract-survival rule by applying it to partnerships governed by the UPA[100] and, in the one recorded decision directly on point, to a partnership governed by the RUPA.[101] Such holdings can be interpreted to mean that a partnership's contracts continue to survive both its dissolution and its termination, or that the partnership's post-dissolution winding-up period does not end until contractual obligations in both directions have been fulfilled or discharged by mutual agreement. Under either interpretation, the cases suggest that judges continue to be willing to develop and apply default rules that preserve the components of a partnership's going-concern value when a partner withdraws, unless doing so would violate the express terms of the partnership agreement or the partnership's contracts with third parties.

In summary, we see that partnership law has developed rules that operate to preserve each of the main components of going-concern value when a partner exercises his right to withdraw and obtain a payout of his equity capital. Like the corporation, the partnership locks in the firm's real capital (its investments in specialized assets and valuable contractual relationships), even while it differs from the corporation by permitting individual owners to withdraw their financial capital. And rather than requiring the business to shut down immediately when a partner withdraws, partnership law contemplates a winding-up period during which the whole business can be sold without interruption of its operations. These conclusions confirm Hansmann, Kraakman, and Blair in their insight that the protection of going-concern value is one of the primary functions of the law of business entities, a function important enough that the partnership and corporation each developed its own means for fulfilling it.

II. THE TRADEOFFS OF PAYOUT RIGHTS AND FINANCIAL LOCK-IN

Although partnership law has developed rules that protect going-concern value when a partner exercises his payout right, other potential costs of that right remain. Most obviously, the partnership must raise the cash needed to honor the right. And, perhaps more importantly, an independent valuation method must be employed when

100. *See* HURT ET AL., *supra* note 54, at § 7.14[B] nn.19–21 (collecting cases).

101. Larson v. McNichol, No. Civ.A. CV-04-119, 2005 WL 2724179, at *3 (Super. Ct. Me. Mar. 11, 2005). The small number of cases on point might owe to the fact that the RUPA is not that old and that a sizable minority of states continue to use the UPA. Moreover, careful drafters of partnership contracts will specify what happens when the partnership dissolves or terminates, reducing the number of instances in which courts must fall back upon a default rule.

the partners cannot agree on how much the departing partner's interest is worth. Besides being potentially inaccurate, valuation methods can be employed opportunistically, with the form of the opportunism depending on the method employed. Given these intrinsic costs of the payout right, why does partnership law continue to grant it by default rule, rather than simply locking in capital as the corporation does?

In this part of the Article, I propose an answer to this question. I argue that payout rights complement two other characteristics of the partnership: the non-transferability of partner control rights, and the possibility for partnerships to be formed inadvertently, without each partner's intention to convey his capital to a distinct legal entity. Although both of these characteristics serve valuable functions in the partnership, they can produce a bilateral-monopoly problem and a heightened freezeout hazard when not combined with payout rights.

The corporation has neither of the attributes that make payout rights especially valuable in the partnership. By default rule, corporate shares are freely transferable, and all control rights appurtenant to share ownership change hands along with the shares. And, unlike partnerships, corporations cannot be formed inadvertently; rather, formation requires a public filing that puts all potential investors on notice that will be committing their capital to a distinct legal person which will be under no obligation to return that capital upon demand. Therefore, the special problems that make payout rights particularly valuable in the partnership do not arise in the typical corporation. Meanwhile, the costs of payout rights would be higher in the corporation: combining payout rights with freely transferable shares would invite arbitrageurs to acquire shares and then force the corporation to buy them back solely on the expectation that the shares' appraisal value will exceed their market price. Such arbitrage would impose costs on the corporation without, at least in most cases, generating social benefits. Given these differences with the partnership, cost-benefit analysis weighs against payout rights in the corporation, which is why corporate law uses capital lock-in as its default rule.

A. Non-Transferability of Control Rights: The Problem of Bilateral Monopoly

The most obvious benefit of the payout right in the partnership is liquidity: the right gives each partner an option to convert his interest to cash at any time. As such, however, the right does not generate a *net* economic benefit, as its exercise imposes a corresponding liquidity (cash-raising) cost on the remaining partners, who must honor the right either by providing the cash themselves or by submitting to the liquidation of their own interests in a sale of the partnership. Therefore, a real economic benefit arises only when gains from trade are possible: when the continuing partners value the exiting partner's interest more than he does, and hence a price exists at which the parties could mutually benefit from an exchange of that interest for cash. Gains from trade could arise because a retiring partner does not wish to hold a large equity stake in a firm that he will no longer have a hand in managing, or because he has a pressing personal need for cash and the remaining partners can raise cash more cheaply than he can, such as by borrowing against the firm's property.

The mere possibility, however, that a cash buyout of a departing partner's interest will generate gains from trade would not justify the imposition of an obligation on the partnership to purchase that interest. After all, if both sides would benefit from an exchange, they could agree to one voluntarily. Rather, to make the case for a payout right—which is, in effect, a put option that imposes a purchase duty on the partnership—we must identify a structural impediment that might hinder a voluntary exchange when a partner wishes to cash out. And such an impediment does appear to exist in partnership law in its prohibition on unilateral transfers of full partnership interests. Thus, the default rule is that each partner may freely assign (by sale or otherwise) his right to receive distributions.[102] But a partner must obtain the other partners' unanimous consent to transfer his control rights, which include his powers to use partnership property for business purposes, participate in its management, vote on partnership decisions, and bind it in contract.[103] To highlight this distinction, the RUPA refers to the partner's right to receive distributions as his "transferable interest," indicating that the other aspects of his partnership interest are not freely transferable.[104]

The restriction on transfers of partner control rights is a corollary of the principle that no person can join a partnership without all partners' consent. This principle makes sense in light of the powers that a partner enjoys to use partnership property, participate in its management, and incur debts for which all partners are jointly and severally liable.[105] Given such powers, each partner will naturally insist upon having a say over who else can acquire a full partnership interest.

102. REVISED UNIF. P'SHIP ACT § 503.

103. Such a transfer would effectively make the transferee a partner in the firm, and new partners can be admitted only with the permission of all partners. *Id.* §§ 503(a)(3), 401(i).

104. *Id.* § 102(23).

105. *Id.* § 306(a).

But the restriction creates a problem when a partner wants to cash out, because it makes his fellow partners, acting as a group, the only possible purchasers of his control rights.[106] I say "acting as a group" because the requirement that all partners consent to a transfer of a full partnership interest effectively disables the remaining partners from bidding against each other for the interest of a departing partner.

If a departing partner lacked a payout right, the remaining partners would have him over a barrel. They could simply refuse to deal with him, perhaps because of ill will surrounding the circumstances of his departure. Or, even if the remaining partners were amenable to a deal, the two sides might have difficulty reaching a mutually agreeable price due to the bilateral-monopoly problem. Not only would the remaining partners be the only potential buyers of the withdrawing partner's control rights, but in most instances the withdrawing partner would be the only available seller of such rights, as he normally will be the only partner at that point wishing to retire or seek work elsewhere. When a partner is a real person rather than a legal entity, withdrawal usually means a change of jobs, if not careers; partner withdrawals are therefore not daily occurrences in most partnerships.

Besides the payout right, another feature of the partnership that mitigates the bilateral-monopoly problem when a partner wises to cash out is the free transferability of his right to receive distributions. If his fellow partners were to stonewall him, a partner who wished to exit could at least sell this portion of his partnership interest to a third party. But this right to transfer one's claim on distributions is not a complete substitute for the payout right. The power to participate in the control of a business firm has intrinsic value, a point that is well understood by scholars of corporate law, who know that shares constituting a control block sell at a premium to minority shares. Thus, the holder of the control rights that come with a partnership interest might derive satisfaction from managing a business and influencing its strategic direction. And he might enjoy financial benefits as well, the most obvious of which is protection against freezeout because he, unlike someone who merely holds cash-flow rights, has a voice in distribution decisions. It follows that the market price for cash-flow rights bundled

106. Technically, a withdrawing partner does not transfer his control rights to the other partners; rather, his rights are extinguished. In practice, however, one partner's dissociation increases the powers of the remaining partners pro tanto. For example, the withdrawal of one partner in a four-person partnership increases each remaining partner's share of the voting and other management powers from twenty-five percent to thirty-three percent. Therefore, a payout that a partner receives upon withdrawal includes compensation for the transfer to the remaining partners of his control rights (along with his cash-flow rights, assuming he has not already assigned these to someone else).

with control rights would exceed the market price for those cash-flow rights (i.e., the transferable interest) alone. It is this pro-rata control premium that will be the subject of the negotiations characterized by bilateral monopoly when a partner wishes to depart, because the other partners are, collectively, the only possible buyers of the control rights the premium represents.[107]

The freezeout hazard that could arise from a partner's sale of his transferable interest is an illustration of the general problem that results from the separation of ownership and control.[108] And this problem is a further reason that free transferability of cash-flow rights is not a complete substitute for a payout right. When a partner sells his transferable interest, his cash-flow rights detach from his control rights, which could alter how he exercises those control rights.[109] This partner's financial incentive is no longer to maximize the value of distributions; rather, it is to maximize the value of other benefits he can obtain from the partnership, such as wages (or "guaranteed payments") he might charge the partnership for his labor, perquisites (such as a bigger office), and so on. He also has less incentive to work hard because

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107. Under the RUPA, a partnership that is winding up must pay off its debts and then distribute any remaining property (presumably at this point, cash) ratably among holders of transferable interests, regardless of whether those interests remain in the hands of the original partners or have been transferred to third parties. REVISED UNIF. P'SHIP ACT § 806. In other words, partners who have sold their transferable interests receive no payout at this stage. This does not mean, however, that the drafters of the RUPA thought that a partner's control rights lacked independent economic value. They surely would have known of the reality of corporate control premiums and the costs of the separation of ownership and control. (Note that, when a corporation dissolves, the final distribution of value is similarly made among shares ratably regardless of whether the shares were part of a control block.) There are two more plausible explanation for the distribution rules in the partnership upon winding up. First, winding up often occurs when the underlying business is shutting down, in which case control rights are being extinguished. Second, when dissolution occurs but the business is to continue, the cash used to make the final distribution will normally have been raised in a sale of the whole firm, intact and for a price representing the bundled value of all cash-flow rights and control rights in the firm. To then set a value for control rights shorn of distribution rights would require the employment of a third-party appraiser, an expense that the drafters of the RUPA presumably believed that the majority of firms would not want to incur at this stage. As a consequence, the pre-termination market price for transferable interests will equal the expected present value of distributions in the ordinary course of business plus a pro rata control premium multiplied by the probability of a change-of-control sale of the firm in the future. By the same logic, the market price of minority shares in a corporation will reflect the possibility of a future merger or acquisition in which all shares are purchased and receive the same deal price.

108. Perhaps the most famous discussion of the problems caused by the separation of ownership and control is found in the 1932 book *The Modern Corporation and Private Property* by Adolf Berle and Gardiner Means. While its focus is the corporation, the problems the book discusses can arise in any firm in which cash-flow rights and control rights are held by different parties.

109. *See* Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 793–94 (2017) (describing how agents who do not bear the full costs of their actions might not work as hard and might seek to divert value from investors to themselves, with a consequent reduction in the overall value of the enterprise).

he no longer holds a pro rata claim on the fruits of his labors. The foreseeable consequence of these changes in the partner's incentives is a reduction in the value of the business over which he still exercises control. And that reduction in value will be reflected in the market price for a transferable interest.[110] By contrast, when a partner with a full partnership interest exercises his payout right, no separation of ownership and control results; rather, his bundled control rights and cash-flow rights are transferred to whomever prevails in the subsequent sale of the firm.[111] By avoiding the loss of value caused by separating ownership from control, this bundled transfer should yield a payout for the partner that exceeds the price he could obtain from a sale of his cash-flow rights alone.

A final drawback of a sale of a transferable interest is that the selling partner remains jointly and severally liable for future partnership debts.[112] And a partner who wishes to retire or otherwise exit will find this prospect unattractive because he may then feel compelled to continue to exercise his control rights in order to minimize his continuing exposure.[113] Dissociation, by contrast, ultimately extinguishes the partner's liability for future partnership liabilities along with his control rights.[114]

Interestingly, the fact that partners are jointly and severally liable for partnership liabilities means that the net value of a partnership interest will sometimes be negative. This will occur when the partnership is insolvent, or if the partnership simply has large debts and the partner has sold his cash-flow rights. But even when the value of a partnership interest is negative, a bilateral monopoly would still arise if that partner wished to withdraw but lacked rights to dissociate and force a sale of the firm. In that situation, the roles of buyer and

110. Although the remaining partners will continue to have productive incentives, they might be willing to go along with a scheme to cut out the third-party holder of the transferable interest by, for example, recharacterizing cash distributions to all partners as fees for services rendered.

111. If third-party appraisal rather than an auction is used to value the partnership interest, the appraiser is supposed to determine the interest's value based on the appraiser's estimate of the amount that a sale of the whole firm would obtain. REVISED UNIF. P'SHIP ACT § 701(b).

112. REVISED UNIF. P'SHIP ACT § 503(f).

113. Notably, he will be far more risk-averse when voting on partnership decisions than he would be if he still had a claim on profits, another potentially value-destroying consequence of a partner's sale of his transferable interest.

114. If withdrawal results in dissolution, winding up, and then termination, the former partner will subsequently have no liability for partnership debts for the simple reason that the partnership will then no longer exist. If the partner merely dissociates but the partnership continues, the RUPA provides that the ex-partner has no liability for post-dissociation partnership liabilities except for those liabilities that (1) arise fewer than two years after his dissociation and (2) are to claimants that did not know of his dissociation. REVISED UNIF. P'SHIP ACT § 703(b).

seller would reverse: now, the departing partner would want to buy a release from his rights and obligations as a partner, but the remaining partners would again have him over a barrel because they would be the only possible sellers of that release. The partner's rights to dissociate and force a sale enable him to buy a release without the consent of the other partners for a price equaling his share of the partnership's debts.[115]

As described earlier, bilateral monopolies can lead to drawn-out negotiations because neither side can turn to a third party to make a deal if the other side proves intransigent. Reaching a mutually acceptable price might be particularly difficult if the bargaining space is wide, perhaps because, in the case of an exiting partner, he is desperate for cash and thus willing to sell at a deep discount, and his copartners know this. The consequent costs of negotiation, delay, and holdout could be considerable. A right to a cash payout of an amount determined by an independent valuation method is a mechanism for breaking the deadlock. Indeed, the mere threat of the right's exercise could ease negotiations by narrowing the bargaining space. Whereas without the right the bargaining space comprises the difference between the highest price the remaining partners are willing to pay and the lowest price the departing partner is willing to accept, the payout right transforms that space into the positive difference, if any, between the remaining partner's estimate of the price the independent valuation would assign to the departing partner's interest and the departing partner's own estimate of that price. Therefore, the parties' projections of the valuation price will anchor negotiations, just as projections of a jury award anchor settlement talks.

To be sure, there will be situations in which the remaining partners do not in fact value the departing partner's control rights more than he does and hence there is no joint surplus to be realized from exchange. This could occur if the remaining partners have no easy way to raise cash, perhaps because the partnership property is already mortgaged. This possibility is perhaps another reason that partnership law gives each partner—not just the withdrawing one—the option to demand a sale of the whole firm upon any partner's withdrawal. This option relieves each partner of the obligation to pay for the interest of the one who has withdrawn. Each partner can decline to bid at the sale, instead using it as an opportunity to cash out his own interest as well.

115. If he has not already sold his transferable interests but the partnership is insolvent, then he will obtain his release at a price equaling his share of the partnership's *net* debts—that is, its debts minus the proceeds from the sale of the firm, assuming the buyer does not assume those debts.

The same bilateral-monopoly problem does not arise when corporate shareholders wish to liquidate their positions. As noted earlier, the default rule in the corporation is that all control rights appurtenant to share ownership are fully transferable along with the cash-flow rights. Free share transferability is compatible with the corporate form because shareholders are not agents of the business and do not enjoy access to its property. All they can do is elect directors, ratify some fundamental transactions, and exercise appraisal rights in connection with certain mergers. Therefore, when a shareholder wishes to sell his control rights, the corporation itself, acting on behalf of the other shareholders, is not the only party permitted to buy those rights. In consequence, the same justification for payout rights is absent.

To be clear, my argument is not that situations will never arise in which a corporate shareholder wished he had a payout right. Certainly, there will be times when a shareholder wishes to exit his position but cannot find a third-party buyer willing to pay as much for his shares as he believes they are worth. The problem of asymmetric information can arise in any firm, including in those organized as corporations. And this problem can make outsiders less confident in their ability to appraise a firm accurately than insiders are. This lack of confidence will, in turn, translate into a diminished willingness to pay for an interest in the firm, as it suggests a larger risk premium. A shareholder wishing to liquidate his position might thus wish he had the option to force the corporation to buy back his shares for a price equaling what insiders know is their true value. But asymmetric information is not a problem particular to firms organized as corporations: it also arises in firms organized as general partnerships, and for that matter as limited partnerships, LLPs, and LLCs. In other words, superior insider knowledge is not a problem produced by the choice to organize a firm as a partnership rather than a corporation, and it therefore does not help us understand why partnership law grants payout rights as a default rule but corporate law does not. While payout rights for shareholders would certainly generate gains from exchange in some situations, the drafters of corporate statutes evidently believe that such gains would not, at least in the majority of corporations, outweigh the costs of such rights.

B. Partnership Formation and the Hazard of Involuntary Lock-In

I have noted the possibility that, in the absence of payout rights, partners might stonewall one of their copartners who wished to cash out, offering him nothing for his interest even if an economic surplus could be realized from their buying it. Such stonewalling could be understood as a specific example of the more general hazard of freezeout, which occurs when those who control a firm refuse to distribute cash to non-controlling equityholders, and those equityholders cannot find third-party buyers willing to pay a price for their interests that approximates the interests' pro rata share of the firm's projected profits. One reason that the sale of a full ownership interest to a third party might be impossible is that, as in most partnerships, the organizational rules simply forbid it. Even, however, when equityholders have the right to transfer their full interests, they might be unable to exercise that right if would-be buyers fear that the firm's controllers would deny them distributions indefinitely. This form of freezeout is well known in corporate law, arising especially in closely held corporations.[116] Indeed, it is a foreseeable hazard, and anyone who voluntarily acquires corporate shares is on notice of it and can adjust for it, such as by applying a discount to the price they offer for the shares or insisting as a condition of the purchase that the charter be amended to provide for payout rights.

By contrast, a business owner can become a partner in a partnership, thereby effectively exchanging his investment in the business for a partnership interest, without intending to do so. As provided in the RUPA, a partnership comes into existence when two or more persons associate "to carry on as co-owners a business for profit . . . , whether or not the persons intended to form a partnership."[117] The law's recognition of unintentional partnerships protects third parties (through joint and several partner liability for the business's debts) and, sometimes, the business owners themselves (such as by authorizing acts of contribution).[118] But the recognition of unintended partnerships would be unduly harsh if the resulting entities locked in financial capital like corporation do. No legitimate interest would be protected by a rule that enabled controlling owners of a business to tie up a co-owner's capital indefinitely even though that co-owner neither agreed to grant them that power nor indeed was aware that he had conveyed his capital to a distinct legal entity.[119] The payout right thus makes sense as a default rule in the partnership, as freezeout

116. *See, e.g.*, Donahue v. Rodd Electrotype Co. of New Eng., Inc., 328 N.E.2d 505 (Mass. 1975).

117. REVISED UNIF. P'SHIP ACT § 202(a).

118. HURT ET AL., *supra* note 54, § 2.04[C].

119. My logic here might seem inconsistent with the general principle that each person is assumed to know the law, including, one might argue, the law of partnership formation. But the evident purpose of the rules of inadvertent partnership formation is to protect parties who lack legal sophistication but have acted in good faith, not to reward parties who have set a trap for the unwary. *See, e.g.*, Vohland v. Sweet, 433 N.E.2d 860 (Ind. Ct. App. 1982).

can then occur only when a business's owners have knowingly assumed freezeout risk, such as by agreeing to a partnership for a term. Put another way, partnership law reflects the common-sense notion that, if a firm's owners desire the power to freeze each other out, they should have to bargain for it expressly.

One could argue that the distinction drawn here between deliberate and inadvertent investment in a distinct legal entity proves too much, as people also sometimes acquire shares in a corporation unintentionally, such as by inheritance. Perhaps such "involuntary" shareholders should similarly be able to force the corporation to buy back their shares. But inherited shares will always be traceable to an investor who acquired them voluntarily and thus had the opportunity to discount for freezeout risk. And that discount will have left this voluntary shareholder with more wealth to leave to his heirs in other forms. Therefore, a grant of payout rights to those heirs would constitute a windfall, as it would leave them with an inheritance that exceeded the value of the devisor's property in his own hands. And this windfall would come at the expense of the other shareholders of the corporation, who would have to bear the costs of the payout rights' exercise.[120]

C. The Costs of Payout Rights: Cash-Raising Costs, Valuation Risk, and Opportunism

Not only would cash payout rights provide fewer benefits in the corporation than they do in the partnership, but they would also generate higher costs. To see why, I will first describe the general costs of cash payout rights, and I will then describe why the free transferability of corporate shares would make such rights more burdensome to the typical corporation than they are to the typical partnership.[121]

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120. A better case for a court's granting of payout rights to minority shareholders would be to remedy a situation in which the freezeout hazard was unforeseeable even to the corporation's initial investors, perhaps because shares were to be widely held and conditions were such that a control bloc was unlikely to form. The famous Massachusetts case of *Donahue v. Rodd Electrotype Co. of New England, Inc.*, in which the Supreme Judicial Court of Massachusetts held that controlling shareholders could not cause the corporation to buy back their shares unless it offered to buy out minority shareholders at the same price, appears to have involved such facts. 328 N.E.2d at 519–21.

121. By specifying *cash* payout rights, I am assuming that payout rights for shareholders would be circumscribed by the same rules that the partnership employs to prevent the exercise of such rights from threating going-concern value.

The most obvious cost of the cash payout right is that it forces the firm to come up with cash to honor it. The firm will have to draw down on its cash reserves, borrow, raise funds from the remaining owners, or bring on new equity investors. Besides generating transaction costs, these means for raising cash can impose risk-bearing costs (if the remaining owners are forced to invest more of their own funds) or search costs (if new investors must be brought in).

The second main category of cost generated by cash payout rights arises from the valuation problem. Some method must be employed for assigning a value to the departing owner's interest if the parties cannot agree on one. As described earlier, the traditional valuation method in the partnership is a sale of the whole firm by auction. In theory, this method has the benefit of accuracy because bidders at an auction bear the costs of misvaluation (overbidders suffer a real loss while underbidders, assuming they do not prevail at the auction, suffer an opportunity cost) and therefore have an incentive to appraise the item for sale accurately. Yet valuation through sale of a whole business also imposes significant burdens. The general transaction costs of both preparing for a whole-firm auction (such as the costs of lining up financing) and then conducting the auction could be substantial. Moreover, a sale results not just in valuation of the departing owner's interest but also in the potential transfer of all interests to new owners, an unappealing prospect if the remaining owners do not want to lose control.

To prevent the loss of their ownership interests in a forced sale, the non-withdrawing owners could form a coalition and bid on the firm collectively. Indeed, we can assume that this is often what happens in partnerships. But coordination problems could afflict the coalition if it is large and there are internal disagreements over the firm's value. Moreover, the presence of an informed coalition at an auction will chill bidding because outsiders will rationally fear that they can prevail only by overpaying. The auction may then close at a depressed price. The only party willing to bid against this coalition in order to ensure a fair closing price might be the departing owner, who might also possess insider knowledge. But an owner seeking to cash out his interest might be doing so precisely because he is cash-strapped, a condition that will disable him from bidding to defeat a conspiracy to acquire the firm on the cheap.[122] We see that a going-concern sale does not guarantee an accurate valuation after all.

122. Perhaps the partner could borrow the cash he needs for bidding purposes, but the information-asymmetry problem will make outsiders leery of the only collateral he can offer—that is, the firm itself if he prevails at the auction. (If he had other good collateral then he would not be illiquid, since he could borrow against it instead.)

A further problem with the sale of a business upon one owner's withdrawal is that it invites squeeze-out. Periodically, a co-owner of a business may find himself illiquid in his personal finances. If his fellow owners were to discover that he has fallen into this state, they might then be tempted to exercise their withdrawal rights to force a sale of the business so that they can buy him out at a depressed price.[123] In this way, the forced sale presents an opportunism hazard that will make it an unappealing valuation method to many firms.

The other main independent valuation method is third-party appraisal, now effectively prescribed by the RUPA when a partner dissociates on account of death or personal bankruptcy rather than voluntary withdrawal. Independent appraisal is procedurally simpler than a forced sale, especially if the firm is large. Rather than requiring the remaining owners to organize a competitive auction and line up financing to bid, third-party appraisal merely requires them to submit their proposed valuation to the appraiser. Moreover, less is riding on the outcome, as the remaining owners do not face the prospect of losing their ownership stakes as they do in a forced sale if personal illiquidity prevents them from bidding competitively at the auction. Still, the method is not costless, as each party might need to hire an expert to prepare a valuation proposal for submission to the appraiser—who, if an arbitrator rather than a judge, will also have to be paid.

Third-party appraisal also presents inaccuracy and opportunism hazards, although in both cases of different natures than those presented by an auction of the whole firm. The method's evident advantage in terms of accuracy is that it cannot be distorted by a shortage of informed potential buyers, as an auction can be. But the appraiser's lack of "skin in the game" is also a disadvantage because he has no direct financial incentive to arrive at the right answer. And the same problem of information asymmetry that would discourage outsiders from bidding at an auction will also hamper an appraiser chosen precisely because he is an outsider and thus disinterested. Interestingly, information asymmetry has different implications for third-party appraisal than for an auction, because unlike a bidder the appraiser suffers no direct loss if he overvalues rather than undervalues the firm. Therefore, rather than producing systematic discounting, information asymmetry should produce errors distributed

123. *See* Larry E. Ribstein, *A Statutory Approach to Partner Dissociation*, 65 WASH. U. L.Q. 357, 385–86 (1987) (describing the squeeze-out problem that arises when some owners are illiquid and cannot demonstrate to potential lenders their firm's true value).

symmetrically around the firm's true value. From an ex ante perspective, the firm's owners may prefer this.

As we have seen recently in the context of corporate mergers, a payout right whose value is determined by a third party has the further disadvantage of encouraging arbitrage when ownership interests are freely transferable. If investors have reason to suspect that the appraiser will assign a higher price to those interests than the market does, they might buy interests solely for the purpose of immediately forcing the firm to cash them out.[124] Such arbitrage could impose significant cash-raising costs on the firm without generating an offsetting social benefit. Certainly no benefit will be realized if the arbitrage occurs because the appraiser overvalues the firm (rather than because the market undervalues it), a significant risk given that the appraiser lacks the direct incentive possessed by market investors to valuate the firm accurately.[125]

This discussion indicates that there is no perfect valuation method: auction and third-party appraisal both entail transaction costs along with hazards of inaccuracy and opportunism. Regardless, however, of which method is chosen, we know that its total costs will rise with the frequency with which payout rights are exercised. It is thus unsurprising that both the corporation and the partnership limit those rights, albeit in different ways. The corporation does so by granting payout rights only in connection with some mergers, offering full share transferability as the substitute source of liquidity in other circumstances. And the partnership does so by denying payout rights to mere assignees of a partner's right to distributions;[126] rather, payout rights are available only to investors who have been accepted into the

124. The firm could mitigate this problem by denying payout rights to investors who acquired their interests only recently. Such a rule would surely discourage professional arbitragers, but it would not prevent arbitrage by current investors, who could work in the reverse order by first forcing the firm to cash out their interests at the appraisal price and then restoring their positions by buying new interests at the market price.

125. In the merger appraisal case of *DFC Global Corp. v. Muirford Value Partners, L.P.*, the Delaware Supreme Court held that the deal price in a merger was a strong indicator of the target firm's fair value because it resulted from a process in which, among other factors, "many parties with an incentive to make a profit had a chance to bid." 172 A.3d 346, 349 (Del. 2017). The holding thus discourages the Delaware Chancery Court from second-guessing a price reached through a bidding process in which the bidders have a direct financial incentive to appraise the firm for sale accurately.

126. The RUPA specifies that the "only transferable interest of a partner in the partnership is the partner's share of the profits and losses of the partnership and the partner's right to receive distributions." REVISED UNIF. P'SHIP ACT § 502 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1997). A partner's assignment of his transferable interest is not an act of dissociation and thus does not compel the partnership to purchase his interest. *Id.* §§ 601, 701. On the other hand, a transferee may seek dissolution of the partnership by court order, which the statute directs courts to issue upon a determination that "it is equitable to wind up the partnership business." *Id.* § 801(6).

firm as partners. This constraint in the partnership naturally reduces the frequency with which payout rights are exercised and hence the total cash-raising and other costs that will be generated.

Not only does free transferability of shares in a corporation serve as a liquidity substitute for general shareholder payout rights, but it also would greatly increase the costs of such rights if they were granted. Free transferability would render unworkable the forced-sale option for valuating shares when payout rights were exercised, as anyone hoping to acquire control of the firm could buy just one share and then exercise the payout right to force a sale. Many public corporations would be continually on the auction block, and the hold-up hazard—whereby shareholders demanded side payments from managers desiring to hold onto their jobs—would be considerable. And valuation by third-party appraisal would also be too frequent to be cost-justified due to transaction costs and the hazard of appraisal arbitrage. Put simply, many corporations would be besieged by shareholders demanding payouts. It therefore makes sense for the corporation to employ a rule of capital lock-in that limits payout rights to dissolution and certain mergers, events over which the board of directors has control.

One might argue that allowing any shareholder to force a sale of a corporation at any time could have the advantage of allowing for the quick removal of poorly performing managers, thereby lowering agent costs—the costs from self-seeking conduct and incompetence when managers rather than investors control a firm.[127] Notably, such agent costs are generally higher in the corporation than in the partnership, owing to the separation in the corporation of control rights (held primarily by the board) from cash-flow rights (held by shareholders).[128] If, however, the payout right were a cost-justified method for curbing the costs of managerial incompetence and misconduct, we should be more likely to see it in the corporation than in the partnership, whereas we actually observe the reverse. Therefore, we can infer that the drafters of general incorporation statutes and of most corporate charters believe that the additional principal costs—the costs generated when investors exercise control of a firm—would exceed the avoided agent costs if any shareholder could force the sale of a corporation at any time.[129] Such principal costs would include disruption of operations, the high transaction costs of endless auctions, and the costs of holdup.

127. *See* Goshen & Squire, *supra* note 109, at 767.
128. *Id.* at 772.
129. *Id.* at 784 (defining principal costs).

D. Payout Rights in the Hybrids: The Limited Partnership, LLC, and LLP

I have argued that two distinctive attributes of the partnership explain why it, unlike the corporation, gives its equityholders payout rights by default rule: its restrictions on transfers of owner control rights and the possibility of inadvertent partnerships. If my argument is correct, it raises the question whether the presence of both of these attributes in a business form is necessary to make payout rights preferable to financial capital lock-in as the organizational default setting, or whether the presence of either alone would be sufficient.

History does not appear to give us an example of a business form that could be formed inadvertently but that made control rights fully transferable. Therefore, we could only speculate about whether such a form would feature payout rights or financial capital lock-in as its default rule. But we do have several real examples of the converse: business forms that restrict transfers of owner control rights yet require a public filing and hence cannot be formed inadvertently. Indeed, all three of the modern, limited-liability alternatives to the corporation—the limited partnership, the LLC, and the LLP—follow this pattern. Each is thus a hybrid with respect to the attributes of the traditional partnership that, in my view, explain why it grants payout rights by default rule. So the question becomes, do these hybrids also grant payout rights by default rule? If the answer is yes, the implication is that, at least in the opinion of the drafters of the forms' respective governing statutes, non-transferability of owner control is sufficient to justify payout rights. But if the answer is no, the implication is that the possibility of inadvertent entity formation is also needed to justify payout rights as a business form's default setting.

Although the relevant statutes vary, both across forms and over time, when considered as a whole they suggest that restrictions on transfers of control rights are normally sufficient to make payout rights preferable in the majority of businesses that wish to utilize the form, justifying such rights as a majoritarian default rule. Only in recent years, when all three forms became generally available to the point that they largely overlapped in terms of what they offered business organizers, have the drafters of their governing statutes sought to differentiate them by changing the default settings in the limited partnership and LLC to one of financial capital lock-in, while leaving payout rights as the norm in the LLP. In effect, the most recent statutes for the limited partnership and LLC supply default rules meant to appeal not to the majority of all firms seeking a limited-liability alternative to the corporation, but rather to just a majority of the subset of those firms that also would, for whatever reason, prefer not to organize as an LLP.

To see this pattern emerge, we begin with the limited partnership, the oldest of the three arrangements. Medieval in origin,[130] the limited partnership has been authorized by statute in most U.S. states since the nineteenth century.[131] Desire for harmonization led the National Conference of Commissioners on Uniform State Laws (I will call them the "Uniform Law Commissioners") to promulgate the Uniform Limited Partnership Act in 1916. Its successor, the Uniform Limited Partnership Act of 1976, remains in force (as amended in 1985) in a majority of states today. The 1916 and 1976 acts are essentially the same in terms of the organizational features that interest us here. Naturally, both require public registration,[132] an evidently universal feature of statutes authorizing business entities with at least one limited-liability equity investor. Both acts also grant certain control rights to limited partners, including rights to veto the admission of new partners (general or limited),[133] to inspect the firm's books and records and demand an accounting,[134] and to apply for dissolution and winding up by court decree.[135] Paralleling the normal rule for general partners, the two acts make limited partners' cash-flow rights freely transferable, but not their control rights.[136] Finally, both statutes give limited partners a cash-only payout right for the fair value of their interests, payable on six months' notice.[137] Evidently, the Uniform Law Commissioners thought that the restrictions on transfers of limited-partner control rights were sufficient to make payout rights preferable to capital lock-in for the majority of firms that would choose to organize as limited partnerships, justifying such rights as the statutory default setting.

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130. Hansmann et al., *supra* note 39, at 1372.

131. The first state to authorize the limited partnership by statute was Louisiana in 1808. The arrangement is there called the partnership *in commendam*, the initial rules for which the Louisiana legislature derived from the French Code of Commerce, which called it the *societé en commandite*. Nicolai Von Kreisler, *The Partnership in Commendam: Tax Consequences and Business Risks*, 36 LA. L. REV. 260, 260–61 (1975). The first American common-law jurisdiction to authorize the limited partnership by statute was New York in 1822. Act of Apr. 17, 1822, ch. 244, 1822 N.Y. Laws ch. 259.

132. UNIF. LTD. P'SHIP ACT § 201(a) (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1976) [hereinafter UNIF. LTD. P'SHIP ACT 1976]; UNIF. LTD. P'SHIP ACT § 2 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1916) [hereinafter UNIF. LTD. P'SHIP ACT 1916].

133. UNIF. LTD. P'SHIP ACT 1976 §§ 301, 401; UNIF. LTD. P'SHIP ACT 1916 § 9.

134. UNIF. LTD. P'SHIP ACT 1976 § 305; UNIF. LTD. P'SHIP ACT 1916 § 10.

135. UNIF. LTD. P'SHIP ACT 1976 §§ 802, 803; UNIF. LTD. P'SHIP ACT 1916 § 10.

136. UNIF. LTD. P'SHIP ACT 1976 §§ 701, 702; UNIF. LTD. P'SHIP ACT 1916 §§ 18, 19.

137. UNIF. LTD. P'SHIP ACT 1976 §§ 603–05; UNIF. LTD. P'SHIP ACT 1916 § 16(b)-(c).

The next limited-liability entity to appear on the scene was the LLC. Although it was first authorized by Wyoming in 1977,[138] the LLC did not become a major competitor to the limited partnership until the 1990s and in particular until promulgation of the Uniform Limited Liability Company Act of 1994.[139] The LLC proved to be more attractive to most firms than the limited partnership because it granted limited liability to all equity investors (in the LLC called "members")[140] and allowed them to participate in management without thereby forfeiting their liability shields.[141]

Naturally, the Uniform Limited Liability Company Act of 1994 conditions formation of an LLC on a public filing.[142] Except for this requirement and its rule of limited liability, the entity contemplated by the 1994 act is partnership-like in structure. Thus, it is an at-will arrangement unless the members agree to a term.[143] Members' cash-flow rights are freely transferable but their control rights are not.[144] Finally, members enjoy payout rights,[145] again suggesting that the non-transferability of owner control rights was considered sufficient to justify such rights as the organizational default rule.

At virtually the same time that the LLC became widely available, the third unincorporated, limited-liability option for modern businesses appeared: the LLP. Like the LLC, the LLP provides limited liability to all equity investors, dispensing with the limited partnership's requirement that there be at least one "general" partner. However, the first few LLP statutes offered only a "partial shield," meaning that each partner lacked personal liability for the negligence of other partners but was fully on the hook for the partnership's contractual obligations.[146] Yet matters soon changed in this regard, and in 1997 the Uniform Law Commissioners added an article to the RUPA

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138. Wyo. Stat. Ann. §§ 17-15-101 to -136 (repealed 2010) (originally enacted 1977).

139. Although neither Delaware nor New York adopted this act, they did enact their own LLC statutes at about the same time. Delaware Limited Liability Company Act, DEL. CODE. ANN. tit. 6 § 18-1102 (2021) (originally enacted 1992); N.Y. LTD. LIAB. CO. LAW § 101 (McKinney 2021) (originally enacted 1994).

140. UNIF. LTD. LIAB. CO. ACT § 303 (NAT'L CONF. COMM'RS ON UNIF. STATE L. 1996).

141. *Id.* §§ 301, 302.

142. *Id.* § 202.

143. *Id.* § 203(a)(5), and comments thereto.

144. More specifically, the default rule is that a member's "distributional interest" is freely transferable, but the transferee does not become a member unless authorized by the operating agreement or all members consent. *Id.* §§ 501–03.

145. Members can dissociate at any time, and if the LLC is an at-will arrangement it must then purchase the member's interest for cash. *Id.* §§ 602(a), 603(a)(1).

146. *See* CARTER BISHOP & DANIEL KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶ 15.02[3][e][ii] (Nov. 2021) ("The first LLP statutes provide only a partial shield, covering tort but not contract claims.").

authorizing "full shield" LLPs, in which partners have the same degree of limited liability that is enjoyed by corporate shareholders.

The RUPA as amended in 1997 provides that an LLP can be formed only upon the filing of a "statement of qualification" with a designated public authority.[147] In virtually all other material respects, LLPs authorized by the RUPA are governed by the same rules that the act applies to partnerships without limited partners. Thus, regardless of whether a partner is general or limited, his right to receive distributions is freely transferable but his control rights are not. And both general partners and limited partners possess cash payout rights. Over thirty states and territories have adopted these 1997 amendments to the RUPA, making the full-shield LLP the version in use in the majority of U.S. jurisdictions.[148]

Like the LLC, the full-shield LLP has proven to be more attractive than the limited partnership for most firms because it confers limited liability on all partners. Recognizing that the traditional limited partnership had lost much of its competitive appeal, the Uniform Law Commissioners decided to overhaul it, promulgating a new Uniform Limited Partnership Act in 2001. As the official commentary to that act explains, the revamped limited partnership is tailored to the needs of two types of enterprise: "sophisticated, manager-entrenched commercial deals whose participants commit for the long term" and "estate planning arrangements."[149] The Uniform Law Commissioners assumed that the organizers of both types of enterprise would prefer not just "strong centralized management" but also "passive investors with little control over or right to exit the entity."[150] Accordingly, the 2001 act eliminates payout rights for both general and limited partners.[151] To date, the act has been adopted by twenty-one states, meaning that limited partnerships continue to assume their traditional form in the majority of U.S. jurisdictions.

Even in states that adopted the new, specialized form of the limited partnership, the field of partnership-like forms with limited equityholder liability remained crowded. In particular, the many

147. REVISED UNIF. P'SHIP ACT § 1001 (NAT'L CONF. COMM'RS ON UNIF. STATE L. 1997).

148. In several states—including California and New York—the LLP can be used only by a partnership of professionals such as lawyers, architects, or accountants. *See* THOMAS E. RUTLEDGE & ELIZABETH G. HESTER, A PRACTICAL GUIDE TO LIMITED LIABILITY PARTNERSHIPS § 8, 5 STATE LIMITED LIABILITY COMPANY & PARTNERSHIP LAWS (Aspen 2008).

149. UNIF. LTD. P'SHIP ACT Prefatory Note (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2001).

150. *Id.*

151. *Id.* §§ 504, 601, 603. Other changes that make this new limited partnership more corporate-like include perpetual duration (section 104(c)), and permission for limited partners to participate in management without losing their liability shield (section 303).

partnership-like features of the LLC made the arrangement largely redundant in jurisdictions that had also authorized full-shield LLPs. Therefore, the Uniform Law Commissioners once again rolled up their sleeves, and in 2006 they produced a new uniform act for the LLC. So far, this act has been adopted by 20 U.S. jurisdictions.[152] To better differentiate the LLC from the LLP, the 2006 act makes the LLC more like the corporation in several structural particulars. For example, it changes the default rule on continuity: whereas previously the LLC was an at-will arrangement, it would now have "perpetual duration."[153] And, in harmony with this change, the 2006 act replaces the payout right with a lock-in rule: members can now obtain a capital payout of the their full interests only if the company is dissolved and wound up unless the LLC agreement provides otherwise.[154] Business owners who desire limited liability but not all of the mandatory features of the corporation (such as merger-linked appraisal rights) can now opt for capital lock-in in perpetuity by forming an LLC, or for payout rights by forming an LLP, in either case without the necessity of varying the organizational default settings.

CONCLUSION

In her famous 2003 article *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, Margaret Blair described the historical importance of the business corporation's rule of capital lock-in, whereby shareholders can obtain a payout of their capital only with the permission of the board of directors. Blair described how lock-in of shareholder capital protects the firm's going-concern value by preventing inopportune liquidation or partitioning of firm assets.

In contrast with the corporation, the partnership grants each partner the right to obtain a payout of his capital at any time unless the partners have agreed otherwise. Yet firms organized as partnerships presumably also have going-concern value worth protecting. If this presumption is correct, two inferences follow. First, the partnership must employ alternative means for protecting going-concern value when a partner wishes to exit the arrangement and withdraw his

152. UNIF. LTD. LIAB. CO. ACT (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2006).

153. *Id.* § 104(c).

154. *Id.* § 404. Essentially the same rule is found in the LLC statute on the books in Delaware, which many business organizers now select as the state of organization for their LLC. Although Delaware's statute provides for a distribution to members upon resignation, it further specifies that members may not resign before the dissolution and winding of the company, an event that requires the affirmative vote of two-thirds of the members. DEL. CODE ANN. tit. 6, §§ 18-603, 18-604, 18-801 (2021).

capital. And second, there must be good reasons for the partnership to employ these alternative means rather than simply locking in capital as the corporation does.

I have argued in this Article that both inferences are correct. As for the first, partnership law employs safeguards that prevent disruption of the firm's operations, fragmentation of its assets, and cancellation of its profitable contracts when a partner withdraws and exercises his payout right. As Morgan Ricks has shown, partnership law requires that a withdrawing partner be paid in cash, and it allows any partner to demand a sale of the whole firm when a partner withdraws. In combination, these rules allow the underlying business to continue without disruption of its operations or fragmentation of its property even when the partnership itself formally dissolves. I have shown that partnership law also provides for the firm's contracts to survive withdrawal of a partner even if the partnership itself consequently dissolves and is terminated, unless the contracts provide otherwise. In these ways, partnership law preserves each of the main components of going-concern value when a partner cashes out. It therefore can be said that partnership law locks in the firm's *real* capital—its investments in specialized assets and profitable contractual relationships—even while allowing departing partners to withdraw their financial capital.

As for the second inference, this Article has advanced the thesis that the partnership has two distinctive attributes that make payout rights more valuable than they would be in the corporation. One of these is partnership law's prohibition on unilateral transfers of full partnership interests. Because the holder of a partnership interest possesses important control rights, including powers to manage the business, use its property, bind it in contract, and incur debts for which all partners are answerable, this restriction is necessary to ensure that each partner has the power to determine who can act on his behalf. But the restriction can create a bilateral-monopoly problem when a partner wishes to exit, as the other partners are, collectively, the only possible buyers of his control rights. The payout right solves the bilateral-monopoly problem by compelling the remaining partners to acquire those control rights at a price determined by an independent valuation method, which traditionally takes the form of an auction of the whole firm.

In the corporation, by contrast, the default rule is that the full bundle of rights that come with share ownership, comprising both cash-flow rights and control rights, are freely transferable. Free transferability of shares eliminates the bilateral-monopoly problem when a shareholder wises to liquidate his position because the corporation is not the only potential buyer of those shares. At the same time, free share transferability would make payout rights more expensive to administer than they are in the partnership, as arbitrageurs could acquire shares solely for the purpose of forcing the corporation to buy back the shares whenever the arbitrageurs suspected that the shares' appraisal value would exceed their market price. Such arbitrage would impose costs on the corporation while serving no positive economic purpose. The implication is that payout rights and free transferability of control rights are mutually incompatible means for enabling equity investors to liquidate their positions. It is therefore unsurprising that we do not see business forms that provide both as a matter of default rule.

The second distinctive attribute of the partnership is that it can be formed unintentionally. While this rule protects third parties who reasonably assume that each owner of a business stands behind its debts, and also protects co-owners who reasonably assume that they can seek contribution from the others, it would create an unexpected freezeout hazard if it meant that each co-owner could be denied access to his financial capital even though he never knowingly conveyed his capital to a distinct legal entity. The payout right in the partnership thus reflects the common-sense proposition that persons can be deemed to have surrendered their right to realize the cash value of their property only when they have intended to do so. Corporations, by contrast, cannot be formed inadvertently, and anyone who purchases shares is on notice that a freezeout problem may arise if he cannot easily find a buyer for them.

Even, however, when a distinct legal entity can only be formed through the formality of a public filing—thereby ruling out inadvertent formation—the essential tradeoff between payout rights and free transferability of control rights arises, suggesting that organizers of most business firms will want its owners to have one source of liquidity or the other, but not both. Thus, in the LLP, where partner control rights are non-transferable, we find payout rights as the default rule. The limited partnership traditionally provided payout rights as well, and it continues to do so in the majority of states. Finally, payout rights were initially provided as a matter of default rule in the LLC, but subsequent overlap with the LLP led statute writers to revamp the LLC to make it more appealing to the set of firms that desire a corporate-like structure but not all the mandatory rules that come with incorporation.