Whose Partnership Is It Anyway?: Revising the Revised Uniform Partnership Act's Duty-of-Care Term

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WHOSE PARTNERSHIP IS IT ANYWAY?: REVISING THE REVISED UNIFORM PARTNERSHIP ACT'S DUTY-OF-CARE TERM

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The problem in designing the appropriate [partnership] statute is that partnership relationships (and, accordingly, the costs and benefits of particular [default] rules) are as variable as the types of businesses that adopt the partnership form. There is little resemblance between a small family farm and a big-city law partnership.1

INTRODUCTION

The above quoted language is taken from Professors Bromberg and Ribstein’s leading treatise on partnership,2 which concludes that where the default rules3 family farmers expect conflict with the default rules big-city lawyers expect, the ideal partnership statute should

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2. The Uniform Partnership Act defines a partnership as “an association of two or more persons to carry on as co-owners a business for profit.” Unif. Partnership Act § 1(1), 6 U.L.A. 1 (1969) [hereinafter UPA]; the Revised Uniform Partnership Act § 202(a) regulates the creation of a partnership, stating “the association of two or more persons to carry on as co-owners a business for profit creates a partnership, whether or not the persons intended to create a partnership.” Revised Unif. Partnership Act § 202(a) (1992) [hereinafter RUPA].
3. “Default terms” are mechanisms that enable courts to enforce contracts and agreements that are silent or indefinite regarding a term or terms. Traditional default term doctrine teaches that default terms are pre-set and apply unless the parties contract for a different term. For some of the recent works on default terms, see Ian Ayres & Robert Gertner, Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules, 99 Yale L.J. 87 (1989); Jules L. Coleman et al., A Bargaining Theory Approach to Default Provisions and Disclosure Rules in Contract Law, 12 Harv. J.L. & Pub. Pol'y 639 (1989); Charles J. Goetz & Robert E. Scott, The Mitigation Principle: Toward a General Theory of Contractual Obligation, 69 Va. L. Rev. 967 (1983) [hereinafter The Mitigation Principle]; Charles J. Goetz & Robert E. Scott, Principles of Relational Contracts, 67 Va. L. Rev. 1089 (1981) [hereinafter Principles]; Lawrence Kalevitch, Gaps in Contracts: A Critique of Consent Theory, 54 Mont. L. Rev. 169 (1993). Most commentators agree that default terms should be created to match what the parties would have chosen had they addressed the issue. Coleman, et al., supra, at 165. This Note argues that it is impossible to consistently supply terms that the parties would have bargained to in a default system which applies the same term in every factual situation. The weakness lies not in trying to determine what the parties would have bargained to; rather the weakness is in setting the gap-filler before examining the facts of each individual case. Setting the default term before examining the facts of a case makes it impossible to consistently supply the term the parties would have bargained to unless all parties that fail to supply a certain term would have bargained to exactly the same result. This is especially true in partnership law, because partnerships are formed for a wide variety of reasons, such as tax savings, convenience or tradition, and operate in tremendously varied circumstances.
strive to embody terms that reflect the farmers’ expectations.\textsuperscript{4} Professors Bromberg and Ribstein, by endorsing the sacrifice of the expectations of Goliath for those of David, recognize that no single default rule\textsuperscript{5} can meet the expectations of all partnerships,\textsuperscript{6} and embrace an approach that purports to meet the expectations of all partnerships except large ones.\textsuperscript{7} Large partnerships, such as the big-city law firm are expected to protect themselves through contract.\textsuperscript{8} Therefore, although a single default term may not be consistent with the expectations of all partnerships,\textsuperscript{9} Bromberg and Ribstein believe that a properly selected single default term can overcome this problem.

Drawing distinctions among the expectations of partnerships based solely on their size, however, ignores the host of other factors that influence the terms those who form partnerships expect. Because people form partnerships for highly individualized reasons, partnerships have widely varied expectations regarding how they will operate. Therefore, when a partnership fails to specify a term in its partnership agreement, or has no partnership agreement, a single default term may not consistently meet partnership expectations even among small partnerships. Categorization based solely on size, therefore, is inappropriate.

Take, for example, two medical partnerships, each composed of three doctors.\textsuperscript{10} In the case of the first partnership, the three doctors attended medical school together and have full confidence in each other’s competence as doctors. Their primary motivation for combining practices was to decrease their individual risk of incurring a large malpractice judgment capable of putting any one of them out of business. The fact that they formed the partnership expecting to share the

\textsuperscript{4} The term the partnership “expects” is the term the partners would have agreed to had they addressed the issue.

\textsuperscript{5} A “single default standard” is one that, unless contracted around, supplies the same term in all factual situations. \textit{See} Steve Thel, \textit{Bromberg and Ribstein on Partnership,} 45 Bus. Law. 1381, 1384 n.16 (1990) (book review). One example is RUPA § 404(d) which states that, unless otherwise agreed, partners are held to a standard of care assigning individual liability only after a finding of gross negligence or recklessness. RUPA, \textit{supra} note 2, § 404(d).

\textsuperscript{6} For the sake of readability, this Note refers to the expectations of “the partnership” when referring to the collective intent of the partners at the time of formation. Obviously, a partnership is a creation of law and can no more have an “intent” than can a corporation or a trust.

\textsuperscript{7} \textit{See} Bromberg & Ribstein, \textit{supra} note 1, § 1.01(d), at 1:11; \textit{see also} Thel, \textit{supra} note 5, at 1383 & n.11 (noting that Bromberg and Ribstein support the tailoring of gap-fillers to contain the terms small, un counselled partnerships would expect).

\textsuperscript{8} Bromberg & Ribstein, \textit{supra} note 1, § 1.01(d), at 1:11.

\textsuperscript{9} The partnership form of business organization has become increasingly popular in recent years. In 1970, there were 936,000 partnerships in the United States; by 1985, the number had increased to 1,714,000 with total receipts of $302,733,000. U.S. Bureau of the Census, \textit{Statistical Abstract of the United States} 495-98 tbls. 823-29 (1988).

\textsuperscript{10} Part III.C expands this hypothetical.
risks of their negligence makes it reasonable for a court to fill a gap in their partnership agreement regarding the standard of care with a low standard of care such as gross negligence. Under such a standard, losses occurring due to the ordinary negligence of one doctor will be shared by all three. Just as the doctors share in each other’s profits, they share in each other’s losses that are due to ordinary negligence—giving them what they expected going into the partnership—a less risky practice.

In the second partnership, the three doctors are brothers who formed a partnership because it was their father’s dying wish. The youngest brother, unfortunately, is a lousy doctor. The older brothers likely would have insisted on a higher standard of care (had they addressed the issue) to govern their practice—perhaps one of ordinary care—to protect themselves from sharing the burden of expected frequent malpractice judgments against the least-skilled brother/doctor.

Thus, one factual disparity can make a single default term inadequate for consistently meeting partnership expectations. The need to discern the expectations of the parties in the gap-filling process arises from the need to provide a neutral enforcer of private agreements. Fairness or efficiency concerns cannot be the basis of a court’s departure from meeting the expectations of the partnership. If a court enters into a reallocation of rights, thereby interfering with the private ordering arranged by the partners, then it has overstepped its bounds. Courts must recognize partnership expectations as legitimate concerns in gap-filling and tailor its gap-fillers accordingly. For example, some business people choose the partnership form because of the tax advantages partnerships receive under the Internal Revenue Code.

11. Partnerships frequently form, operate and dissolve without intervention by legislatures or courts. The only situation where a court is called upon to “fill a gap” is where there is a dispute implicating issues covered by neither the law of partnerships nor the partnership agreement, regardless of whether that agreement is written, oral or implied.

12. The “standard of care” is the degree of care partners must exercise in their actions to avoid liability to the partnership and to the other partners. Only a court or a legislature may determine the duty the partners and the partnership owes to third persons.

13. Under the Internal Revenue Code, partnership income is not taxed until it is distributed to the partners. See I.R.C. § 701 (1988). An association, to qualify for partnership tax status, must more resemble a partnership than a corporation. This status is evaluated under the factors laid out in Morrissey v. Commissioner, 296 U.S. 344, 353-55 (1935) (listing four factors to be weighed in the corporate resemblance test); see also A.H.M. Daniels, Issues in International Partnership Taxation 10-11 (1991) (tracing the evolution of the corporate resemblance test).

A corporation’s owners—the shareholders—are taxed twice on their income; once when earned by the corporation, and then again when the earnings are distributed to the shareholders in the form of taxable dividends. Partnership has the advantage of being a transparent pass-through organization.

As a general rule, the partnership is the most advantageous form of entity for federal income tax purposes. The partnership’s major advantages over the “C” corporation are the following: (1) partners may deduct any partner-
while others do so to obtain high fiduciary duties among owners, while still others choose partnership because it is often easier to form a partnership than to form a corporation.

Partnership law has been governed by the Uniform Partnership Act ("UPA") for over sixty years. Recently, the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), the group that drafted the original UPA and the Uniform Commercial Code, drafted the Revised Uniform Partnership Act ("RUPA") to replace certain sections of the UPA they believe are outdated. There is currently a debate among scholars over what standard-of-care default term the RUPA should contain.

The UPA, while silent on the issue of the duty of care among partners, has been interpreted by courts to impose a duty of "ordinary care" on partners in the absence of a specified term to the contrary. Conversely, the RUPA supplies a lower standard-of-care term similar to corporate law's "business-judgment rule." Both of these gap-fillers are single default terms. Such single default terms cannot consist-

ship losses on their own income tax returns, whereas a corporation's tax losses cannot be deducted by shareholders; and (2) the use of the partnership form avoids the potential double taxation that may result from the use of the C corporation.


15. Partnerships may be formed by informal agreement of the partners. Bromberg & Ribstein, supra note 1, § 1.01(b), at 1:2. Corporations, however, must file with the state of incorporation, have a charter, officers and other statutorily required elements. Del. Gen. Corp. Law § 101(a) (1993) (corporations must file a certificate of incorporation); Model Business Corp. Act § 1.20 (1993) (same); Del. Gen. Corp. Law § 141, 142 (1993) (requiring corporations to have officers and directors); Model Business Corp. Act § 8.01, 8.03, 8.40 (1993) (same).

16. RUPA, supra note 2.


18. Compare Norwood P. Beveridge, Jr., Duty of Care: The Partnership Cases, 15 Okla. City U. L. Rev. 753 (1990) and Dickerson, supra note 13, at 141-43 (stating that unless otherwise agreed, partners are to be held to an ordinary care standard) with Bromberg & Ribstein, supra note 1, § 6.07(f), at 6:85 (stating that unless otherwise agreed, partners' acts are to be judged under a gross negligence standard).


20. The RUPA standard allows a negligent partner to seek indemnification from her partners where she has individually paid a judgment arising out of her act relating to the partnership business so long as she has not engaged in "grossly negligent or
ently meet partnership expectations because they supply the same standard of care in all cases.\textsuperscript{21}

To accommodate the different needs of different partnerships, state legislatures must tailor their standard-of-care gap-fillers to meet partnership expectations as closely as possible. The tailored gap-filler should strive to minimize the added expense of the process to courts and litigants resulting from the need to conduct a factual inquiry. To meet this goal, legislatures should replace RUPA section 404(d) with a provision that is textured to apply different gap-fillers in different scenarios.\textsuperscript{22} Such an approach would enable courts to meet partner expectations while minimizing added costs to litigants and courts associated with a gap-filling provision that accounts for factual disparities.

This Note's proposals emphasize respect for party autonomy and expectations in the gap-filling process. Part I analyzes the need to meet party expectations when gap-filling. Part II explains why single default terms generally cannot meet those party expectations. Part III analyzes the debate between the advocates of an ordinary care standard and those who favor the application of the business-judgment rule to partnerships. This part utilizes a hypothetical to illustrate the fact that the single default terms advocated by both sides of the debate are incapable of meeting partnership expectations. Part IV proposes an amendment to RUPA section 404(d) that would enable courts to adjust the standard of care gap-filler to reflect partnership expectations.

I. MEETING PARTNERSHIP EXPECTATIONS IS THE KEY TO LEGITIMATE JUDICIAL GAP-FILLING

This section explains that to legitimize judicial gap-filling and ensure the orderly functioning of partnerships, it is crucial that the RUPA's gap-fillers be consistent with the expectations of partnerships.\textsuperscript{23}

\begin{itemize}
  \item reckless conduct, intentional misconduct, or a knowing violation of the law." \textit{Id.} § 404(d).
  \item \textsuperscript{21} See Jules L. Coleman, Risks and Wrongs 178 (1992); Kalevitch, \textit{supra} note 3, at 171.
  \item \textsuperscript{22} Courts often make the similar determination of the level of skill to which a professional is to be held—ordinary care or extreme care. \textit{See} W. Page Keeton et al., Prosser and Keeton on the Law of Torts, § 32, at 187 & n.39 (5th ed. 1984); \textit{see also} Coyne v. Cirilli, 607 P.2d 1383, 1386 (Or. Ct. App. 1980) (applying expert standard to podiatrist because foot doctor is a "specialist" as a matter of law); Baker v. Story, 621 S.W.2d 639, 642 (Tex. Ct. App. 1981) ("The evidence in this case justifies the conclusion that Dr. Story was a specialist in the field of neurosurgery, so that he would be held to a higher standard than that which would be applied to [a non-specialist].").
  \item \textsuperscript{23} This Note sometimes refers to "parties" instead of "partners." This is because the literature on default terms is not specifically addressed to partnerships. The reasoning of the literature, however applies to partnership as a contractual relationship.
\end{itemize}
While some scholars take the position that courts should never supply gap-fillers on the grounds that doing so violates the principle of party autonomy, 24 most recognize that default terms are invaluable because they increase the flexibility of parties operating under long-term agreements. 25 Such flexibility is necessary to accommodate the wide range of unexpected contingencies that can and do arise during the performance of long-term contracts and agreements. 26 Moreover, gap-fillers decrease the cost of contracting by allowing the parties to avoid negotiating a term for every possible contingency; 27 additionally, parties to an “incomplete” contract can address future contingencies without being hampered by a rigid agreement. 28

More importantly, especially in the case of partnerships formed without a formal agreement, 29 the standard-of-care term will be one of the most important default terms partners seek to enforce. When an informal arrangement goes sour, and litigation ensues over the actions of the partners, the standard of care to which the partners are held must come from a gap-filler. A court should and will fill in gaps to enforce incomplete partnership agreements if it finds that the partners

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24. See Kalevitch, supra note 3, at 176-82.
26. See id.
27. See id.
28. See id. Professor Barnett has stated: “Many foreseeable contingencies, given their low probability, are better off left unnegotiated ex ante in the hopes that they will not materialize or will be handled cooperatively ex post if they do.” Id.
29. Partnerships formed without the specific intent to do so are sometimes called inadvertent partnerships. J. Dennis Hynes, Agency and Partnership: Cases, Materials, Problems 457 (1989). The law treats such an association as a partnership even though the “partners” never specifically intended to create a partnership. The law only requires that the “partners” have the general intent to form “an association.” Bromberg & Ribstein, supra note 1, § 2.01, at 2:1. Bromberg and Ribstein explain in their treatise as follows:

[D]efining partnership in terms of intent leaves open the question of what must be intended. Clearly, it is neither necessary nor sufficient in all circumstances for the parties to call their relationship a “partnership.” Such a rule would not adequately address situations involving very informal relationships and would permit the parties to evade unwanted consequences of partnership vis-à-vis third parties by the simple expedient of choosing some other name for their relationship.

Id. See also Waugh v. Carver, 126 Eng. Rep. 525 (Ct. Comm. Pl. 1793). In Waugh, the court explained that:

It is plain upon the construction of the agreement, if it be construed only between the [parties to the agreement], that they were not nor ever meant to be partners. They meant each house to carry on trade without risk of each other, and to be at their own loss . . . . That was the agreement between themselves. But the question is, whether they have not, by parts of their agreement, constituted themselves partners in respect to other persons?

Id. at 532.
intended to be bound by their agreement. It does not follow, though, that a court has free reign to supply terms ad hoc to fill the void; rather, a court's legitimacy rests on its ability to supply a term consistent with the partnership's expectations.

One might argue, however, that when the members of a partnership select the partnership format, they consent to their relations with each other being judged by standards set by the state in the form of mandatory terms. But academic circles have rejected the wisdom of having mandatory terms, and most statutory schemes have abandoned them as well.

There is, however, scholarly debate about how to best select default terms. There is general agreement, though, that default terms should be set to reflect "what the parties would have wanted"—otherwise known as the parties' "hypothetical intent." Hypothetical intent is a presumed intent used to approximate the parties' actual intentions and to provide a justification for inserting state-created terms into a

30. See, e.g., U.C.C. § 2-204(3) (12th ed. 1990) (stating that incomplete contracts should be enforced if the parties intended to contract and there is a reasonably certain basis for shaping a remedy).

31. See Kalevitch, supra note 3, at 170-72.

32. For purposes of readability, this Note sometimes refers to the partners as "members."

33. "Mandatory terms" are synonymous with "non-waivable provisions." In the partnership context, this includes the duty of good faith and fair dealing. RUPA, supra note 2, § 103(b)(5). Mandatory terms cannot be contracted around no matter how honestly the parties desire it.

34. See, e.g., RUPA, supra note 2, § 103(b) (stating the general policy of allowing the RUPA to be contracted around and listing the only unalterable provisions of the RUPA); U.C.C., supra note 29, § 1-102(3) (stating that all provisions of the U.C.C. are avoidable through contract except the duty of good faith). A discussion draft of the RUPA also evinces support for abandoning mandatory terms. The revision committee stated that the RUPA provisions should be default terms with respect to the respective rights of the partners. See Revised Uniform Partnership Act (Discussion Draft 1989), reprinted in Alan R. Bromberg & Larry E. Ribstein, Bromberg and Ribstein on Partnership 44 (Supp. 1989) [hereinafter Discussion Draft]. Specifically, the RUPA enables partners to modify or eliminate all duties except for the duties of good faith, fair dealing, and loyalty. RUPA, supra note 2, § 103(b)(4) & (5). Under the RUPA, the duty of care may be reduced from its default level of "gross negligence or recklessness," so long as the reduction is reasonable. Id. § 103(b)(4). This standard is in accord with the law and economics position. See Dickerson, supra note 13, at 148-49. Professor Dickerson commented on the overall approach of the RUPA towards the duty of care stating:

A last means of avoiding the duty of care is found in RUPA section 103(b)(4). It provides only that partners cannot "unreasonably reduce the duty of care." Admittedly, it may be difficult to show that a prospective waiver is in good faith, represents fair dealing, and is not unreasonable if it extends to a cause of action arising out of a particular partner's willful misconduct. However, it is easier to contemplate an enforceable provision protecting a party from his or her own reckless or negligent conduct or ordinary negligence. After all, if a standard of good faith or fair dealing is itself attenuated, that standard may be compatible even with a waiver of liability for reckless behavior.

Id. at 148.
private agreement. The argument goes, if the parties would have consented to the term supplied by default, then it is almost as if the parties did consent to it. There is a trade-off involved that allows the court to enforce agreements that parties intended to be binding, even though the parties failed to specify terms. The court, thereby, intrudes on party autonomy to enforce party intent.35

Beyond the general agreement that default terms should be set to reflect "what the parties would have wanted," scholars sometimes disagree about the proper "parties" on whose expectations default terms should focus.36 Hypothesizing "what the parties would have done" enables courts to enforce agreements that the parties intended to be enforceable.37 A serious problem arises, however, where the default terms are set by seeking the hypothetical intent of hypothetical parties instead of the hypothetical intent of the actual parties. The search for a default term that reflects the expectations of hypothetical parties, (e.g., parties who always act "efficiently" or "fairly") delegitimizes the role of courts as gap-fillers.38

When the parties have made a private agreement—an independent ordering of their respective rights and responsibilities—a court's proper role is that of neutral enforcer of the agreement.39 Because courts must not favor one party over another, courts may take the necessary step of hypothesizing what the actual parties would have done; however, hypothesizing what hypothetical parties would have done is a step away from the parties' actual intent not justified by the need to fill gaps.

States, therefore, should amend the RUPA standard-of-care term to allow their trial courts to more closely approximate actual partnership expectations. Just as the Uniform Commercial Code40 and the Restatement (Second) of Contracts41 have adopted flexible default standards for commonly omitted terms, the RUPA can create its own more flexible gap-filling process to honor partnership expectations. States must recognize when considering the adoption of the RUPA that no single default rule for the standard of care among partners can effectively or consistently meet partnership expectations.

35. Id. But see Barnett, supra note 24, at 859 (espousing a theory that the parties' act of contracting indicates their consent to the gap-filling process of the jurisdiction in total).

36. Compare Coleman, supra note 20, at 164-66 (courts should supply the hypothetical intent of the actual parties) with Dickerson, supra note 13, at 152-53 (courts should apply ordinary care—the presumed intent of hypothetical parties).


38. See infra part II.

39. See Kalevitch, supra note 3, at 179 ("Contract rests on autonomy and actual assent as [its] moral basis . . .").

40. See U.C.C., supra note 29, § 2-204(3).

41. See Restatement (Second) of Contracts § 204 (1979).
II. SINGLE DEFAULT TERMS CANNOT CONSISTENTLY MEET PARTNERSHIP EXPECTATIONS

This section discusses why single default rules cannot be designed to meet partnership expectations. As discussed in part I, a gap-filler should meet the actual partners' hypothetical intent because that is the best way to maintain respect for the partners when gap-filling.

In the partnership context, utilizing the actual partners' hypothetical intent strikes a balance between the important goal of enforcing contracts that the partners intended to be binding, and the similarly important goal of respecting partner autonomy. Professor Coleman argues for the use of the actual parties' hypothetical consent as follows:

The duties the parties have explicitly imposed on one another are legitimately enforced against them because they are the terms to which the parties have actually consented. The default rule imposes rights and responsibilities to which the parties would have consented. When securing the actual consent of negotiating parties is impossible, determining what they would have agreed to is the best alternative. Hypothetical consent is a proxy for actual consent. Therefore, to the same extent and in the same way that consent justifies a court imposing the rights and responsibilities made explicit in a contract, hypothetical consent justifies imposing the rights and responsibilities that are implied by the application of the default rule.42

Nevertheless, because different partnerships operate with different priorities in factually disparate situations,43 a single default term—even one premised on "hypothetical intent," or "what the partnership would have wanted"—cannot be justified on grounds of meeting partnership expectations. The validity of such a premise requires an unrealistic assumption that all partnerships have identical wills.44 Consequently, a textured gap-filler provision is required, because only such a provision can account for the circumstances surrounding the formation and operation of each partnership, and supply a term consistent with the partnership's expectations.45

42. Coleman, supra note 20, at 167; see also Coleman et al., supra note 3, at 639 ("Coercive civil authority is justifiably employed to enforce contractual obligations because the parties have agreed so to constrain themselves.").
43. See Kalevitch, supra note 3, at 171; see also Coleman, supra note 20, at 178 (stating that each party seeks to maximize his or her utility).
44. See Coleman, supra note 20, at 178; Kalevitch, supra note 3, at 171.
45. Some claim, however, that default terms need not be set to meet party expectations. Barnett, supra note 24, at 823. These commentators argue that by contracting, and by failing to specify a term themselves, parties consent to having courts fill whatever gaps they leave with pre-set, single default terms; hence, one default term is as justified as any other. Id. at 823. Parties must be aware of a default rule to "consent" to its imposition. See Kalevitch, supra note 3, at 190. Professor Kalevitch stated:
For instance, the U.C.C. has gap-fillers which are flexibly applied by courts. Section 2-305 provides that where the parties fail to specify the contract price, the court shall determine a reasonable price.\textsuperscript{46} The U.C.C. also provides gap-fillers that require the determination of a reasonable time.\textsuperscript{47} The reasonableness standard gives a court wide latitude to examine the facts of each case in determining what the parties intended.

When a court interprets a partnership agreement, the rules of contract interpretation apply, and the primary goal must be to discern the actual intent of the parties and to give it effect.\textsuperscript{48} Parties to a contract need not jump through linguistic hoops to give their intentions legal significance.\textsuperscript{49} Courts will now look to the circumstances surrounding a contract,\textsuperscript{50} admit parol evidence\textsuperscript{51} and look beyond form to substance\textsuperscript{52} to give effect to the parties' intent. This is evidence of the importance attached to discerning the actual intent of the parties in court.

Though it is impracticable to conduct an individualized probe into the actual parties' actual intent, abandoning the search for the hypothetical intent of the actual parties is not justified.\textsuperscript{53} Thus, when creat-

\footnotesize{The kinds of default rules a consent theory of contract may adopt are different when the parties to a contract are knowledgeable or ignorant of the default rule. \ldots \textsuperscript{[I]}f the parties either have no reason to know the default rule \ldots \textsuperscript{then the state may only adopt conventional default rules that match conventional expectations. In contrast, any default rule may be adopted for knowledgeable parties.}}

\textit{Id. Cf.} Zenichi Shishido, The Fair Value of Minority Stock in Closely Held Corporations, 62 Fordham L. Rev. 65, 94 (1993) (stating that parties must know of penalty default rules for court to legitimately insert them into incomplete contract). Most partnerships, however, are formed informally, with little or no consideration of the UPA. \textit{See} Bromberg & Ribstein, supra note 1, § 2.01(a), at 2:1; Dickerson, \textit{supra} note 13, at 154; Thel, \textit{supra} note 5, at 1383. Thus, the required knowledge of the default rules does not exist during the formation of many partnerships. \textit{See id.} at 1384.

Regardless, partnership is contractual, \textit{see} Bromberg & Ribstein, \textit{supra} note 1, § 1.01(d), at 1:11, and the same factors that support the elimination of non-waivable terms, \textit{see supra} notes 32-33 and accompanying text, also support tailoring the RUPA's standard-of-care term to meet partnership expectations by designing it to account for disparate factual circumstances.

46. \textit{See} U.C.C., \textit{supra} note 29, § 2-305(1).

47. \textit{Id.} § 2-309(1).

48. \textit{See} Kalevitch, \textit{supra} note 3, at 179 (arguing for a "will" theory of contracts grounded in supreme respect for party autonomy). This Note addresses situations where the parties did not foresee the need for the missing term, or consciously did not address it, because of transaction costs that exceeded the utility of bargaining to such a term, thus leaving no expressed or implied intent to discover.

49. \textit{See} John D. Calamari & Joseph M. Perillo, The Law of Contracts § 3-12, at 171 (3d ed. 1987) ("Under Corbin's rules all relevant extrinsic evidence is admissible on the issue of meaning including evidence of subjective intention and what the parties said to each other with respect to meaning.").

50. \textit{Id.}

51. \textit{Id.}

52. \textit{Id.}

ing a gap-filler, the goal should be to meet the actual parties' actual intent as closely as possible. This is done by having the trial judge hypothesize what the actual partners would have done.⁵⁴

Professor Coleman explained the flaw in straying too far from the search for a term that reflects the actual or hypothetical intent of the actual parties:

[Real agents do not find themselves in anything like ideal circumstances. Their actual bargain reflects the reality of their situation; so should any hypothetical bargain struck between them. . . . Instead of completing, even in an attenuated sense, the contract between the [actual] parties, the principle of ideal rational bargaining is just a mask for the real principle: the principle of efficiency.⁵⁵

This masking also appears in default terms that purport to supply the "fair" default term. A court providing the "fair" term is not enforcing the parties undeclared decision to come to "fair" terms. Rather, the court is supplying the "fair" term to be fair.⁵⁶ Abandoning the search for the actual parties' hypothetical intent results in an unjustified increase in expectation costs (defined as the costs of lost court legitimacy and public confidence in the sanctity of contract).⁵⁷

The law and economics scholars attempt to prevent inefficiencies in the partnership's operations when gap-filling by hypothesizing what the parties would have done had they been ideally situated. Such a method of gap-filling is sometimes justified on the grounds that because default terms should mirror the parties' intent as closely as possible, and because all parties desire terms that maximize their joint wealth, a court should supply the jointly efficient term.⁵⁸ But clearly, the concept of contract as a joint-wealth maximizer does not mean that all transactions produce the most joint-wealth possible.⁵⁹

A prime example of this is where one party to an agreement has superior, but legitimate, bargaining power. If a court ignores the superior bargaining position of one party, and fills the gap with its idea of the "jointly efficient" term, the chosen term probably will not be the term the parties would have bargained to had they addressed the

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⁵⁴. The goal must be to match the gap-filler with one of the terms below, in descending order:
1) The actual intent of the actual parties;
2) The hypothetical intent of the actual parties;
3) The hypothetical intent of hypothetical parties.

Id. at 166. As a court proceeds down this list, each step represents an increase in expectation costs (defined as the costs of lost court legitimacy and public confidence in the sanctity of contract).

⁵⁵. Id. at 178.

⁵⁶. Cf. id. at 178 (stating that hypothesizing what ideally situated parties would do is a mask for the goal of efficiency).

⁵⁷. Id.

⁵⁸. See id. at 178.

⁵⁹. Id.
Because the efficiency default seeks the term to which ideally situated parties would have bargained without transaction costs, the party who originally had superior bargaining power will lose an advantage. The party in the stronger position would have forced the weaker party to bear the risk or added expense of a term even if it was not the jointly efficient term. If the benefits to one party of superior bargaining power are legitimate, a court should not deprive a party of those benefits.

Regardless, a court that imposes a default term—for efficiency's sake—that does not reflect what the parties would have wanted, risks decreasing the efficiency of an agreement. Courts seeking the most efficient way of allocating risk among the parties are as prone to err in selecting the efficient term as are those courts that would impose the term selected by the majority of parties. It is difficult both to determine the most efficient term and to determine the most popular term. Professor Coleman recognized that judges lack the information to make informed determinations of what is the most efficient term. He stated that:

Even though the court in applying the relevant default rule aims to promote efficiency, there is no reason to think that it will do a better

60. See id. at 180-81. Professor Coleman states that:
There are technical and substantive objections to imposing on parties ex post what they would have bargained to ex ante. The technical problem arises when a court is asked to determine ex post what parties would have bargained to ex ante. This problem is complicated by the fact that the litigants are likely to offer very different accounts ex post of their ex ante preferences. The incentive to behave strategically may well be overwhelming. Determining what is fair or efficient may turn out to be considerably easier than determining what the parties would have agreed to.

The normative problem is more troublesome. What parties to an agreement would have agreed to is a function of their relative bargaining strengths. A person's bargaining strength depends on endowments, information available, alternative opportunities, and the like. Even if a court could determine how the parties would have allocated risks ex ante, in doing so it may be doing no more than reinforcing bargaining inequalities. In short, courts may not be particularly well suited to determine ex post what parties would have bargained for ex ante, and even if they could, courts might well exacerbate, rather than alleviate, relative bargaining inequalities.

It is one thing for a court to recognize and enforce bargains that are the result of inequalities in relative bargaining positions when the parties have explicitly agreed to them; it is another for a court to impose unfair allocations of rights and responsibilities in the absence of an explicit agreement among the parties to do so.

Id.

61. Id. at 178.
62. Id.
63. See Calamari & Perillo, supra note 48, § 4-4, at 193.
64. Coleman, supra note 20, at 180 ("Individuals will be inclined to rely upon courts to promote their joint wealth, but only to the extent to which they believe that courts are better suited to determine what's in their interest than they are.").
65. Id.
job than will the particular contracting parties. The parties, themselves, also act to maximize their wealth. Whether they are successful often turns on the same considerations that determine whether courts will succeed, for example, the adequacy of information.66

To supply the most efficient term when gap-filling, courts should supply a term consistent with the hypothetical intent of the actual parties.67 Interpretation of a contract in a way that gives legal effect to the actual will of the actual parties is highly efficient. Thus, it makes sense for a court to supply a term that is consistent with what the actual parties would have chosen; such a term is presumptively efficient.68 Regardless, it is clear that a single default term cannot meet party expectations and cannot be justified on those grounds.

III. The Debate Over the Proper Standard-of-Care Term For the RUPA

The problem with single default terms is borne out by the debate between those courts and commentators supporting the application of the business-judgment rule to partnerships and those who support an ordinary care standard for partnerships. The UPA provides no standard-of-care term.69 In the absence of an express term, the judicial approach under the UPA has been to provide a default term of ordinary care that applies to all partnerships in which the partners failed to designate a standard-of-care term.70 Under the UPA (as with all single default terms) courts need not look to the nature of the partnership or any other surrounding circumstances when applying the single default term.71

66. Id.
What about cases in which the parties' intentions, as gleaned from the language of the contract or perhaps even from testimony, are at variance with the court's notion of what would be the efficient term to interpolate into the contract? If the law is to take its cue from economics, should efficiency or intentions govern? Oddly, the latter.

Id.
68. See id.
69. Dickerson, supra note 13, at 111.
70. See generally Beveridge, supra note 17 (surveying American and English cases applying the ordinary care standard). Similarly, Professor Dickerson has explained that:
In recognizing a duty of care between or among partners, the courts have looked to UPA section 18, a provision that focuses on management. UPA section 4(3) also addresses fiduciary concepts, albeit more indirectly; it states that principles of agency law survive the adoption of the UPA. Therefore, the fiduciary duties owed by a partner to the partnership include those owed by an agent to its principal: both the duty of loyalty and the duty of care.

Dickerson, supra note 13, at 115 (citations omitted).
71. Thus there is no need to inquire into circumstances that cannot possibly affect the selection of the default term; there is a choice of one.
Eighty years subsequent to its original drafting, the UPA, currently the law in all of the states except Louisiana,\(^72\) has been overhauled and the revised act soon will be presented to the individual states as a replacement for the UPA. The revised act provides that the duty of care among partners, instead of one of ordinary care, is a lesser duty—a duty to avoid gross negligence.

A. Justifications For UPA's Ordinary Care Standard and Some Weaknesses Therein

Scholars have advanced several arguments for the adoption of an ordinary care standard by the RUPA. First, they argue that the case law supports the ordinary care standard.\(^73\) Second, they claim that agency principles underlying partnership law support the ordinary care standard.\(^74\) Third, they assert that because ordinary care is the current standard, and because partnership is the only business organization affording such a high duty of care, people expect and rely upon the ordinary care standard.\(^75\)

1. Common Law Authority

Some commentators argue that the RUPA standard should be ordinary care—holding partners liable to the partnership for their acts of ordinary negligence—because it is the standard interpretation by courts under the UPA.\(^76\) Accordingly, they argue that the RUPA’s position—which in essence adapts corporate law’s business-judgment rule to the partnership context\(^77\)—is inconsistent with the case law.\(^78\) The drafters of the RUPA claim that the courts have already adopted

\(^72\). Id.

\(^73\). See infra part III.A.1.

\(^74\). See infra part III.A.2.

\(^75\). See infra part III.A.3.

\(^76\). Beveridge, supra note 17, at 756-60 (surveying English and American cases purportedly consistently applying ordinary care standard); see also Dickerson, supra note 13 (arguing that case law supports the ordinary care standard).

\(^77\). See supra note 19. Professor Eisenberg discussed the business-judgment rule in the corporate context in a recent article stating that:

The business-judgment rule consists of four conditions, and a special standard of review that is applicable, if the four conditions are satisfied, in suits that are based on the substance or quality of a decision a director or officer has made, as opposed to the decision-making process he utilized to arrive at his decision. The four conditions are as follows:

First, a judgment must have been made. So, for example, a director’s failure to make due inquiry, or any other simple failure to take action—as opposed to a decision not to act—does not qualify for protection of the rule.

Second, the director or officer must have informed himself with respect to the business judgment to the extent he reasonably believes appropriate under the circumstances—that is, he must have employed a reasonable decision-making process.
the business-judgment rule, and that the revised act only codifies the existing case law.\textsuperscript{79}

2. Extension of Agency Principles

Advocates of the UPA standard also argue that the ordinary care standard is a natural extension of agency principles which survive in the UPA\textsuperscript{80} and which are closely akin to partnership law.\textsuperscript{81} In agent-principal relationships, the agent's duty—a condition that is not satisfied if, among other things, the director or officer knows that the decision violates the law.

Third, the decision must have been made in subjective good faith—a condition that is not satisfied if, among other things, the director or officer may not have a financial interest in the subject matter of the decision. For example, the business-judgment rule is inapplicable to a director's decision to approve the corporation's purchase of his own property.

Fourth, the director or officer may not have a financial interest in the subject matter of the decision. For example, the business-judgment rule is inapplicable to a director's decision to approve the corporation's purchase of his own property.

If these four conditions are met, then the substance or quality of the director's or officer's decision will be reviewed, not under the basic standard of conduct to determine whether the decision was prudent or reasonable, but only under a much more limited standard.


78. See Beveridge, supra note 17, at 756 (arguing that the courts consistently apply an ordinary care standard, and that cases holding partners individually liable for their acts of "culpable negligence" are not applying a lower standard of care, but in actuality are applying a poorly termed ordinary care standard). But see Bane v. Ferguson, 890 F.2d 11, 14-15 (7th Cir. 1989) (Posner, J.) (holding that under business-judgment rule, a law firm is not liable to a former partner for alleged negligent management that affected the retired partner's non-contractual pension payments); Ferguson v. Williams, 670 S.W.2d 327 (Tex. Ct. App. 1984). In Ferguson, the court stated:

[W]e hold as a matter of law that negligence in the management of the affairs of a general partnership or a joint venture does not create any right of action against that partner by other members of the partnership. It is only where there is a breach of trust, such as when one partner or joint venturer holds property or assets belonging to the partnership or venture, and converts such to his own use, would such action lie. In the ordinary management and operation of a general partnership or joint venture there is no liability to the other partners or joint venturers for the negligence in the management or operation of the affairs of the enterprise . . . .

Id. at 331.

79. UPA Revision Subcommittee, supra note 16, at 151.

80. UPA, supra note 2, § 4(3); Dickerson, supra note 13, at 122.

81. Dickerson, supra note 13, at 122 ("Agency law resembles partnership law in its application of fiduciary duties.").

82. Restatement (Second) of Agency § 379(1) (1957). Section 379(1) states that "[u]nless otherwise agreed, a paid agent is subject to a duty to the principal to act with standard care and with the skill which is standard in the locality for the kind of work which he is employed to perform and, in addition, to exercise any special skill that he has." Id.
nership relations are grounded in the law of agency, a partner's duty must be to use ordinary care.\textsuperscript{83}

While it is true that agency law provides much of the foundation of partnership law,\textsuperscript{84} allowing partnerships to be governed by rules formed by blind analogy to agency law is a mistake.\textsuperscript{85} It is unreasonable to assume that all organizations that choose the partnership form do so to obtain an agency relationship among the partners.\textsuperscript{86} Although presuming the existence of close, personal agent-principal relations among the partners may be reasonable in some partnerships, such a presumption may be inaccurate in other partnership settings. Frequently, partnership is the business form of choice because it is easy to create. Additionally, it is possible that the partners desired to avoid an agent/principal relationship so that they might share the risk of negligence judgments. Consequently, the presumption that one partner seeks an agency relationship with the other partners that reaches the fiduciary level, making each partner solely liable for her own negligence, is questionable.

3. Partnership Expectations

Professor Dickerson also argues that those who form partnerships do so because they expect and desire to obtain a high duty of care among partners.\textsuperscript{87} Further, Professor Dickerson argues that partnership law must provide a high standard of care as an alternative to the set of lower fiduciary duties of corporate law.\textsuperscript{88} However, not all partnerships are formed to achieve high fiduciary duties—many are formed for tax and other reasons.\textsuperscript{89} Consequently, imposing a default term that supplies a high standard of care based on an assumption that all partners or partnerships desire a high duty of care is erroneous.

Due to its inflexible nature, a single term will sometimes supply a term inconsistent with the expectations of the partners.\textsuperscript{90} The desire to provide a "partnership haven" with a high default standard of care to those who expect refuge there does not justly thrusting that "ha-

\textsuperscript{83} Dickerson, \textit{supra} note 13, at 121. The law of agency does, however, contemplate situations where the agent and principal agree to be governed by a gross negligence standard (essentially that of the business-judgment rule). The comment to § 379(1) of the Restatement (Second) of Agency states that "an agreement with the principal that the agent is not to be liable to him for negligence not of a gross character is legal." Restatement (Second) of Agency § 379(1) cmt. a (1957).

\textsuperscript{84} Dickerson, \textit{supra} note 13, at 121.


\textsuperscript{86} See Kalevitch, \textit{supra} note 3, at 172 n.5.

\textsuperscript{87} Dickerson, \textit{supra} note 13, at 155.

\textsuperscript{88} Id. at 156.

\textsuperscript{89} See notes 12-14 and accompanying text.

\textsuperscript{90} See Kalevitch, \textit{supra} note 3, at 172 n.5; Thel, \textit{supra} note 5, at 1384 n.16.
ven" on those who expect otherwise, but who have failed to make their intention clear.\textsuperscript{91}

Any rule that proffers "meeting partner expectations" as its justification must, or come as close as possible to meeting, every partnership's expectations.\textsuperscript{92} The NCCUSL, through its promulgation of the RUPA, is not justified in continuing a scheme that will disappoint many partnerships' expectations.\textsuperscript{93}

B. Justifications for the RUPA Business-Judgment Rule and Some Weaknesses Therein

Unlike the UPA, the RUPA squarely tackles the duty-of-care issue. RUPA section 404(d) states that "[a] partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of the law."\textsuperscript{94}

Judge Posner has argued that because of partnership's contractual nature, the business-judgment rule, although a corporate law notion,\textsuperscript{95} is even more appropriate in the partnership context.\textsuperscript{96} Section 404(d) leaves the parties the responsibility to contract for a high duty of care if so desired, and leaves a low standard of care for its default term.\textsuperscript{97} Advocates of the business-judgment rule's adaption to partnership governance offer three main arguments. They argue that low standards of care are relatively efficient at discouraging partner negligence,\textsuperscript{98} that the business-judgment rule encourages partners to make risky, but wise, investments,\textsuperscript{99} and that partners desire a low standard of care so as to share the costs of their ordinary negligence.\textsuperscript{100}

1. Low Standards of Care are Efficient at Discouraging Partner Negligence

The first argument in support of the inclusion of the business-judgment rule in the RUPA is that a high standard of care is needed even less in the partnership context than it is in the corporate context. This claim is defended on the grounds that because partners are owners as well as managers, they have a strong interest in monitoring the actions of their partners to weed out negligence and increase the overall part-

\textsuperscript{91} See Kalevitch, \textit{supra} note 3, at 172 n.5; see also Coleman, \textit{supra} note 20, at 178 (noting that not all parties desire the court to supply "efficient" terms).

\textsuperscript{92} See Kalevitch, \textit{supra} note 3, at 171.

\textsuperscript{93} See id.

\textsuperscript{94} RUPA, \textit{supra} note 2, § 404(d) (emphasis added).

\textsuperscript{95} See Dickerson, \textit{supra} note 13, at 142.

\textsuperscript{96} Bane v. Ferguson, 890 F.2d 11, 14-15 (7th Cir. 1989) (Posner, J.).

\textsuperscript{97} See Dickerson, \textit{supra} note 13, at 147.

\textsuperscript{98} See \textit{infra} part III.B.1.

\textsuperscript{99} See \textit{infra} part III.B.2.

\textsuperscript{100} See \textit{infra} part III.B.3.
Each partner additionally faces the danger of expulsion should her actions result in losses to the partnership. Thus, by imposing a single default term of ordinary care, those people who form partnerships must waste resources contracting around the unneeded protection of tort law. The partners themselves are ultimately believed to be the most efficient guarantors of careful partner actions.

2. A High Duty of Care Impedes the Ability of Partners to Manage the Partnership

A second argument offered for the adoption of the business-judgment rule by the RUPA basically tracks the corporate law justification for the rule. It holds that partners, as managers, must have the freedom to seize valuable partnership opportunities on behalf of the partnership. Sometimes these opportunities are risky, but ultimately they may be wise investments. If the partners are held personally liable (that is, they have no action for contribution from the partnership) for losses incurred in an attempt to act on the partnership's behalf, they will be less likely to seize valuable opportunities for the partnership. Professors Bromberg and Ribstein have stated that:

[T]he risk of harm to the partnership [of a partner's ordinary negligence] is frequently outweighed by the need to give the partner sufficient leeway to exercise discretion on behalf of the partnership. The difference between a partner and a paid agent, of course, is that the partner is subject to individual liability for partnership debts, so that legal liability is less necessary to encourage the agent [partner] to act carefully.

3. Partners Desire to Share the Costs of Their Ordinary Negligence

A third justification for the business-judgment rule in the partnership context is that partnerships expect to have their actions judged by the rule. Some people who form partnerships do so with every intent to treat losses resulting from ordinary negligence as a cost of doing business to be shared equally by the partners. Therefore, the business-judgment rule advocates claim that it makes sense to apply the business-judgment rule to partnerships. While it is possible that many people form partnerships with the intent to have a low standard of

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101. See Special Release, supra note 85, at 56 ("The partners have ample incentives to monitor their co-partners because of their liability for partnership debts and their equal contributions to the firm.").
102. See RUPA, supra note 2, § 601(3) & (4).
103. See id.; Bromberg & Ribstein, supra note 1, § 6.07(f), at 6:85.
104. See Bane v. Ferguson, 890 F.2d 11, 14-15 (7th Cir. 1989).
106. Id. (citation omitted).
care, it is certainly not the only possibility. As Professor Dickerson notes, many partnerships form to obtain the high fiduciary duties and high standard of care provided under the UPA. This is really the difference between the two standards of care. Whether the partners intended to share the costs of their ordinary negligence determines what standard of care they would have chosen.

C. The Advocates of Both Standards of Care are Fighting the Wrong Battle

It is simple to explain the contrasting views that exist regarding the proper standard of care that a partner owes the partnership. The law and economics scholars and those who would retain the status quo under the UPA attack each other's standard-of-care position by analyzing worst-case scenarios. By applying each side's standard to situations where it is clearly inappropriate, both sides illustrate why a single default term cannot consistently meet partnership expectations.

Some criticize the application of the UPA's high default standard of ordinary care on the grounds that such a standard breeds inefficiency in the process of partnership formation, and that it restricts the ability of partners to make decisions that although risky, are valuable partnership opportunities.

In contrast, the proponents of the ordinary care standard argue that applying the business-judgment rule to partnerships conflicts with the desires of those who form partnerships to create high fiduciary duties among partners, and deprives those people of a business organization that can supply those duties.

Both schools correctly assert that the other's standard is inconsistent with partner expectations in some situations. This inconsistency stems from the varied factual circumstances under which partnerships form and operate which result in varying attitudes and expectations regarding the sharing of the costs of ordinary negligence. Thus it is clear that the only type of default rule that can consistently meet partner expectations is one that is textured to account for disparate factual circumstances; primarily, whether the partners view each other as risk sharers or not. A hypothetical clearly illustrates this proposition.

107. Dickerson, supra note 13, at 155-56.
108. See infra part III.C.
110. Compare Dickerson, supra note 13, at 119 (claiming that small and inadvertently formed partnerships expect ordinary care standard) with Bane, 890 F.2d at 14-15 (stating that large professional partnerships expect to contract to the desired term).
111. Bane, 890 F.2d at 14-15.
113. Dickerson, supra note 13, at 154-55.
114. Id.
Recall the three-doctor partnerships discussed in the Introduction. Now suppose that in each partnership, one doctor negligently treats a patient who then sues the partner individually and the partnership as an entity. The suit against each partnership is made possible by the partnership statute which creates joint and several liability among the partners. Subsequently, the patient enforces the judgment against the partnership.

Begin by applying these facts to the case of the first partnership in which the three doctors are of comparable competence, and are familiar with each other’s skill level. Perhaps the three chose to form a partnership to reduce the variability in their expected incomes. By pooling their gains and losses, they can smooth their expected income stream. In such a situation it is quite possible that had they addressed the issue, the partners would have chosen a gross negligence standard—thereby instituting loss sharing in cases of ordinary negligence by a partner.

Now apply the same facts to the second medical trio—where the three doctors are brothers and the two older brothers took the third one into their partnership (even though he went to medical school in the Dominican Republic) because it was their father’s dying wish for them to do so. Being graduates of Prestigious Medical School, the elder brothers surely would select a high standard of care to govern their partnership—thereby insulating themselves from judgments against their less-skilled brother. Because the two elder brothers expect there to be more frequent judgments against their less-skilled sib-

115. See RUPA, supra note 2, § 305(a); UPA, supra note 2, § 13.
116. See UPA, supra note 2, § 13. The UPA states that:
Where by any wrongful act or omission of any partner acting in the ordinary course of the business of the partnership or within the authority of his co-partners, loss or injury is caused to any person, not being a partner in the partnership, or any penalty is incurred, the partnership is liable therefor to the same extent as the partner so acting or omitting to act.

Id. The RUPA provision is in accord with UPA § 13. RUPA, supra note 2, § 305(a).
117. See RUPA, supra note 2, § 401(b) (“A partnership shall credit each partner’s account with an equal share of the partnership profits.”).
118. Professor Weidner, the reporter for the RUPA wrote:
It is not clear what duty of care rule would be included in most partnership agreements if the matter were addressed. . . . If they believe that negligent injuries are an inevitable series of costs that over time will be imposed randomly and equally by all partners, a contract to share losses seems a likely outcome. In such a situation, an agreement to share losses primarily affects the timing of a partner’s loss, not the amount of her loss. The agreement to share losses in effect allows each partner to amortize the losses she incurs. . . . An assumption of equality, therefore, may explain the opinion of those who believe that partners tacitly agree to share the losses caused by each other’s ordinary negligence.

ling than against themselves, they will expect he alone to bear the cost of his malpractice, because had they addressed the matter, they would have chosen an ordinary care standard.

In the latter partnership, ordinary care appears to be the standard of care consistent with partnership expectations. Such a standard would make the negligent partner (brother) liable to the partnership for any judgment paid by the partnership arising out of his own negligence. In the former partnership, the RUPA's single default term conforms to the partnership's expectations by treating the cost of ordinary negligence as a cost of doing business to be shared equally by all the partners.

The hypothetical above exposes the weakness inherent in both the UPA and the RUPA default terms. Each would apply a single standard of care to both of these very different situations. While single default terms are less costly gap-fillers than those that require a court to look to the facts of a case, such inflexible terms make it impossible for courts to consistently provide terms that meet the expectations of partnerships in factually disparate situations. Both the UPA and RUPA single default terms are appropriate some of the time because sometimes the chosen single standard will reflect partnership expectations by chance. The flaw lies not with the substantive terms themselves, but rather lies in the fact that as single default terms, they apply without regard to the situation. Thus, the key to proper gap-filling lies in finding a way to supply the right term at the right time.

IV. Supplying the Right Term at the Right Time

The RUPA revision committee "determined that the primary focus of the statute should be the small partnership, including the inadvertent partnership, since larger partnerships generally have a partnership agreement addressing, and often modifying, many of the provisions of the partnership statute." It is believed that, unlike small partnerships, large partnerships are unlikely to fall victim to a default rule inconsistent with the expectations of the partners. In negotiating the partnership agreement—which large partnerships nearly always have—any offensive default terms likely will be pointed out by counsel. Moreover, if terms are offensive to the partners, the partners will contract around them.

119. See Beveridge, supra note 17, at 765-66.
120. Weidner, supra note 16, at 468.
121. See Coleman, supra note 20, at 178; Kalevitch, supra note 3, at 171.
122. Discussion Draft, supra note 33, at 44.
123. See id.
124. Large partnerships are nearly always represented by counsel and will contract around the RUPA as a form of standard contract. Id.
125. See id.; Ayres & Gertner, supra note 3, at 99.
There is a point at which the cost of deviating from party expectations in the gap-filling process becomes unacceptable. The cost of a streamlined gap-filling process—in terms of lost legitimacy of the gap-filling process and the contracting public’s lost confidence in the “sanctity of contract,”126 outweighs many benefits of streamlining the gap-filling process. At such a point, the court must tailor the process to discern terms that comport with partner expectations and spend its resources to supply a gap-filler that truly reflects partnership expectations.

Additionally, courts must supply some standard of care to hear a suit among the partners involving indemnification or contribution. There also exists, however, a limit to how much time and money courts and litigants can spend in a search of the default term that reflects the actual intent of the parties. Thus, an imperfect world demands the sacrifice of some party autonomy and expectations to facilitate the courts’ enforcement of partially incomplete agreements.

Theoretically, it is possible to nearly eliminate the negative effects associated with disappointing partnership expectations by refusing to enforce an agreement until it is determined what the parties would have done by considering evidence of subjective intent. Such a result, however, would require a highly individualized probe into the parties’ subjective intent. The lack of individualized probes into party intent in most gap-fillers127 implicitly acknowledges that there is a limit to the amount of court and litigant resources we are willing to exchange for reducing expectation costs.

Similarly, monetary costs to courts and litigants may be reduced by a gap-filling scheme with only a single default term, but this would result in high expectation costs. While efficiency costs are paid out of the county coffers, expectation costs are much more difficult to quantify,128 though just as problematic.129 Of the possible solutions to the

127. But see U.C.C., supra note 29, § 2-305 (allowing a court to supply a “reasonable” price); Kalevitch, supra note 3, at 219, which states that “[§ 2-305] does not impose any particular price but calls for a ‘reasonable price,’ which leaves parties free to present evidence as to what they thought was a reasonable price.” Id. This approach is not quite as liberal as it seems. The U.C.C. provides for several “reasonable” terms which are easily determined through—in the case of price—the market price at the time, or through well known customs or trade practices.
128. See generally Kalevitch, supra note 3 (espousing the “will” theory of contract based on respecting party expectations, no matter how unconventional because the cost of disappointing party expectations is too high).
129. Id. Cf. Thel, supra note 5, at 1383-84 (noting the authors’ choice to sacrifice party expectations to achieve efficient gap-filling in the context of sharing capital losses). In his review of Professor Bromberg’s and Professor Ribstein’s partnership treatise, Professor Thel states:
[T]he authors might be expected to propose a more textured rule; however, they seem to feel that a single default rule should govern the sharing of capital losses. A set of clear and simple default rules may reduce litigation costs
problem of balancing the desire for efficient gap-filling and the necessity of meeting partner expectations, a textured rule that allows a court to look to factors and apply differing standards in different cases offers the best hope for attaining the proper balance.

This Note proposes three factors that courts should consider in deciding under what standard of care to judge the actions of partners. Professor Weidner, the reporter for the RUPA, has stated that default terms should be selected so as to supply terms the partners would have chosen. The factors, which are designed to flesh out to what standard of care the partners would have bargained, will enable courts to supply terms the partners considered to be "implicit in their partnership agreements." A court may then supply a term it deems consistent with what the partners believed to be implicit in their agreement.

The first factor a court should look to is the duration or expected duration of the partnership. If the partnership has operated for many years, or by its nature must operate for many years, then it is more likely that the partners expected to share the losses incurred as a result of their ordinary negligence. As Professor Weidner stated, "If [the partners] believe that negligent injuries are an inevitable series of costs that over time will be imposed randomly and equally by all partners, then a contract to share losses seems a likely outcome." Thus, where the partnership's duration is lengthy or is expected to be lengthy, the business-judgment rule is the standard of care more consistent with partnership expectations. Conversely, where the partnership is limited in duration, loss-sharing over time is less of a possibility, and thus, an ordinary care standard is more appropriate.

A second factor relates to each individual partner's record for negligence during her time as a partner. Partners may be willing to share the burden of negligence judgments (by adopting the business-judgment rule) if they believe that their decision to share the burden, in effect, insures their risk of having a negligence judgment rendered against them and being forced to pay it individually. This "insurance" is practical only where judgments against the various partners are spread randomly and equally. If there is a pattern of judgments and be easier for the public to understand, but perhaps the arrangements that partnerships would make cannot be stated in simple rules. If so, then whatever simple rule is adopted will buy the benefits of simplicity at the price of the expectations of some partnerships.

Id. at 1384 n.16.
130. Id. (stating that the "basic idea" behind drafting default rules is to choose the term the parties assume will be supplied).
132. Id. (emphasis added).
133. Id. Professor Weidner analogized the risk self-insurance among partners to what a tax person would dub a "loss-sharing agreement [that] avoid[s] a material distortion of income at the level of the individual partner." Id.
134. Id.
against one or a few partners, then sharing the burden becomes bearing the burden for the less-negligent partners, and an ordinary care standard is more consistent with partnership expectations.

Because partnership relations are affected by the knowledge that the partners have about each other prior to formation, as a third factor, partners who lack knowledge about each other prior to formation will expect a higher standard of care. This is because business people are generally cautious about with whom they associate. Thus, partners who are less familiar with each others’ business practices or skills prior to formation will be less likely to agree to share the losses resulting from a “stranger’s” negligence. Familiarity breeds trust, and makes an agreement to share losses resulting from partners’ ordinary negligence more likely.

After analyzing these factors, a court may better supply the standard of care most consistent with partnership expectations. While this solution is not perfect—there will be times when the standard desired by the partners is not supplied—it comes closer to consistently meeting their expectations than any single default term could.

Conclusion

The status of partnerships as contractual relationships mandates that any standard-of-care gap-filler be consistent with the expectations of the partnership. The wide variety of circumstances surrounding the formation, purposes and operations of partnerships makes it impossible for any single default term to consistently meet partner expectations. Therefore, a textured gap-filler provision is necessary to justify enforcement of incomplete partnership agreements.

States must amend RUPA section 404(d) so that the standard-of-care provision is a textured rule, allowing courts to analyze the factors proposed by this Note and providing courts the discretion to choose between the business-judgment rule and an ordinary care standard. Such a flexible gap-filler provision will enable courts to distinguish between people who form partnerships expecting to share the costs of ordinary negligence and those people who form partnerships expecting each partner to pay for her own negligence, and will allow courts to consistently provide the standard of care that meets those expectations.

135. Id.
136. Id.
137. Id.
138. Id.