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## Partnership Law

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# PARTNERSHIP LAW

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## I. INTRODUCTION

During the Survey period, Texas courts handed down cases emphasizing that a drafter's choice of words in the partnership agreement can have dramatic effects in determining the rights and liabilities of partners. Specifically, the Texas Supreme Court reversed a court of appeals decision that interpreted a partnership's purpose clause in such a way as to dramatically increase a limited partner's ability to act on behalf of the partnership. In other cases, courts showed a willingness to interpret applicable law in such a way as to permit creditors and other claimants to collect against partnership assets, especially where the owners of the sub-

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ject partnership interests had perpetrated a fraud or otherwise acted in bad faith to shield partnership assets. This article is divided into seven main sections that explore recent decisions encompassing the following topics: (1) existence of a partnership; (2) personal liability of members for fraudulent transfers; (3) personal liability of members or managers under agency principles; (4) admission of an estate's representative as limited partner; direct versus derivative claims; (5) purpose clauses and authority of limited partner; (6) divorce and partnership property; and (7) creditors' remedies against a partner.

## II. EXISTENCE OF A PARTNERSHIP

In *Phillips v. Boo 2 You, LLC*,<sup>1</sup> the Austin Court of Appeals considered whether a partnership had been created in the absence of a written partnership agreement between the parties. Boo 2 You, LLC, a Texas limited liability company (Boo), operated a seasonal business that sold Halloween merchandise. Steven Smith (Mr. Smith), as managing member, managed Boo with assistance from his wife, Linda Smith (Mrs. Smith), who was not a member of the company.<sup>2</sup> Gary Phillips (Phillips) had loaned money to Boo for purposes of financing its operating expenses. In 2010, Phillips approached Smith to discuss becoming a member in Boo.<sup>3</sup> Although Mr. Smith did not agree to admit Phillips as a member, the parties executed a Letter of Understanding (LOU) in March 2010. The LOU provided for, among other things, an even split in the net proceeds of stores Smith and Phillips would open together. In exchange for his share of the proceeds, Phillips would contribute half of the expenses associated with opening the new stores and Phillips would also participate in operating the stores.<sup>4</sup> Phillips contended that the LOU "evidenced both the creation of a partnership as well as Phillips's right to one-half of the net proceeds" of Boo.<sup>5</sup>

Phillips subsequently contributed 50% of the expenses for three stores opened by Boo.<sup>6</sup> However, Phillips ceased his participation in the operation of the stores in the second week of October 2010, when he quit his work in the store following a dispute with Mrs. Smith.<sup>7</sup> Boo repaid Phillips the principal and interest of Phillips's \$80,000 loan made to Boo for the 2010 operating season, and no profits from the operations of those stores were shared with Phillips.<sup>8</sup>

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1. No. 03-14-00406-CV, 2016 WL 2907971 (Tex. App.—Austin May 13, 2016, no pet.) (mem. op.).

2. *Id.* at \*1.

3. *Id.*

4. *Id.* at \*1–2. The court of appeals also noted that the agreement contemplated Phillips's participation in the operation of the new stores.

5. *Id.* at \*1.

6. *Id.*

7. *Id.* at \*3.

8. *Id.*

Phillips sued Boo, Mr. Smith, and Mrs. Smith (together, the Appellees), asserting that the Appellees had failed to distribute \$29,638.80 in profits to Phillips in a breach of the parties' partnership agreement.<sup>9</sup> The trial court granted the Smiths summary judgment and sanctioned Phillips, finding that the lawsuit was frivolous and designed to harass the Smiths.<sup>10</sup> On appeal, Phillips argued that a partnership between himself and the Appellees had been established. The Appellees submitted a motion for summary judgment which asserted a lack of any evidence to support the statutory factors demonstrating the existence of a partnership.<sup>11</sup>

The court of appeals analyzed the issue of whether a partnership had been established between Phillips and the Appellees under the Texas Business Organizations Code (TBOC), which contains a five-factor test:

- (1) receipt or right to receive a share of the profits of the business;
- (2) expression of an intent to be partners in the business; (3) participation or right to participate in control of the business; (4) agreement to share or sharing: A. losses of the business; or B. liability for claims by third parties against the business; and (5) agreement to contribute or contributing money or property to the business.<sup>12</sup>

The court of appeals noted that the Texas Supreme Court has endorsed a "totality-of-the-circumstances" approach when applying this test.<sup>13</sup> The presence of none of the five factors indicates that a partnership does not exist, whereas the existence of all five factors establishes a partnership's existence as a matter of law.<sup>14</sup> The court of appeals went on to observe that it is more difficult to apply this test when there is support for some, but not all, factors.<sup>15</sup> The court of appeals proceeded to analyze whether a genuine issue of material fact existed under the factors evidencing existence of a partnership in this case.<sup>16</sup>

Addressing the first factor, the court of appeals held there was a genuine issue of material fact regarding the right to share profits in the business.<sup>17</sup> The court of appeals initially noted that the LOU contained a profit-sharing provision.<sup>18</sup> However, the Appellees claimed that the profit-sharing concept was based on the conditions that (1) Phillips would lend Boo \$80,000 to be repaid following the 2010 season; and (2) Phillips would work at the Boo stores during "the 2010 Halloween season."<sup>19</sup>

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9. *Id.* at \*1. Phillips's other arguments in the pleading asserted that the alleged failure to distribute his claimed share of net profits constituted breach of contract, breach of fiduciary duty, and unjust enrichment.

10. *Id.* at \*2.

11. *Id.* at \*1.

12. *Id.* at \*2 (citing the factors set forth under TEX. BUS. ORGS. CODE ANN. § 152.052 (West 2012)).

13. *Id.* (citing *Ingram v. Deere*, 288 S.W.3d 886, 896 (Tex. 2009)).

14. *Id.*

15. *Id.*

16. *Id.* at \*3–5 (referencing the supreme court's guidance in *Ingram*, 288 S.W.3d at 898–904).

17. *Id.* at \*4.

18. *Id.* at \*3.

19. *Id.*

Phillips did lend Boo \$80,000, but left work after a falling-out with Mrs. Smith in early October and did not come back.<sup>20</sup> The court of appeals noted that profit sharing does not exclusively occur in the context of a partnership, and that persons will not be partners if they do not intend to share profits as co-owners.<sup>21</sup> In examining Phillips's role in the business, the court of appeals noted that Phillips had characterized his work at Boo as recreational in nature with no commitment to work at the stores, and contrasted this against work performed in an ownership role, which would lend support to a claim of a right to share in the business's profits.<sup>22</sup> Ultimately, the court of appeals found that both sides had presented sufficient evidence on the first prong to create a question of fact as to whether the parties intended to share profits in the venture.<sup>23</sup>

The court of appeals emphasized in its analysis of the second factor, expression of an intent to be partners, that this prong should be examined using only "evidence not specifically probative of the other factors."<sup>24</sup> Phillips relied heavily on the LOU in support of his arguments relating to the second factor. However, since Phillips had relied on the LOU in support of his argument for the first factor of the test, the court of appeals reasoned that he was precluded from relying on the LOU to establish the second factor.<sup>25</sup> The court of appeals further noted that the conduct of the parties, including "speech, writing and conduct[.]" should be reviewed when evaluating whether an intent to be partners exists.<sup>26</sup> Phillips did not present evidence that the parties "held themselves out as partners," referred to themselves as partners, held a bank account in the name of the partnership, or created letterhead or other similar items that might otherwise indicate the existence of the claimed partnership.<sup>27</sup> As a result, the court of appeals determined that no question of fact existed with respect to the existence of the second factor.<sup>28</sup>

The court of appeals determined that no question of fact existed regarding the third factor since Phillips admitted in his deposition that he had no control over Boo.<sup>29</sup> The court noted that the third factor and the first factor are given the greatest weight in assessing whether a partnership exists.<sup>30</sup>

Regarding the fourth factor, Phillips argued that the loans he made to Boo constituted a sharing of risk of loss. However, no evidence was intro-

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20. *Id.*

21. *Id.* (citing TEX. BUS. ORGS. CODE ANN. § 152.051(b) (West 2012); *Strawn Nat'l Bank v. Marchbanks*, 74 S.W.2d 447, 450 (Tex. Civ. App.—Eastland 1934, writ ref'd)).

22. *Id.*

23. *Id.* at \*4.

24. *Id.* (citing *Ingram v. Deere*, 288 S.W.3d 886, 900 (Tex. 2009)).

25. *Id.*

26. *Id.* (citing *Ingram*, 288 S.W.3d at 899).

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

duced that the parties had discussed liabilities for third-party claims.<sup>31</sup> In its analysis of this factor, the court of appeals distinguished the discussion of expenses from the discussion of losses, emphasizing that discussion of expenses alone does not suffice to find that parties agree to share losses and liabilities for third-party claims.<sup>32</sup> In its application of this principle to the facts of this case, the court of appeals determined that the \$80,000 in loans made by Phillips was insufficient to create a question of fact as to whether the parties had agreed to share losses and liability for third-party claims.<sup>33</sup>

In examining the fifth factor, the court of appeals disagreed with Phillips's argument that the \$80,000 loan constituted a capital contribution.<sup>34</sup> Mr. Smith had requested this amount as a loan from Phillips, and it was repaid to Phillips with interest less than a year following disbursement.<sup>35</sup> The court emphasized the parties' "lender-borrower relationship," which had been established in the course of prior loans, finding that the terms of repayment and interest rate supported the conclusion that these sums were advanced in the context of a loan rather than partnership contributions.<sup>36</sup> The court of appeals concluded that no issue of fact existed with respect to the fifth factor.<sup>37</sup>

In its analysis of the five factors, the court of appeals found that Phillips had raised an issue of fact with respect to only the first factor, the agreement to share profits.<sup>38</sup> Although this question of fact existed on one of the factors carrying the greatest weight in Texas courts,<sup>39</sup> the court noted that the weight of the evidence did not support Phillips's claim that a partnership had been created. "Under the totality-of-the-circumstances test prescribed by [the supreme court]," the court of appeals ultimately determined that no genuine issue of fact existed as to whether a partnership had been created, and the trial court's judgment was affirmed.<sup>40</sup>

The *Phillips* case emphasizes the necessity of executing a partnership agreement to confirm the existence of a partnership. Business persons in Texas should insist on formalizing their partnership by negotiating and executing a formal written partnership agreement. In the absence of a written agreement, the importance of establishing the nature of the parties' relationship is illustrated by the outcome here. As the court of appeals noted, there was enough evidence in support of Phillips's assertion that the parties had agreed to share profits to create an issue of fact for that factor of the test.<sup>41</sup> However, Phillips failed to distinguish his claimed

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31. *Id.*

32. *Id.* (citing *Ingram v. Deere*, 288 S.W.3d 886, 902 (Tex. 2009)).

33. *Id.*

34. *Id.* at \*4-5.

35. *Id.* (noting that the interest rate of the loans was 12%).

36. *Id.* at \*5.

37. *Id.*

38. *Id.*

39. *Id.* at \*4.

40. *Id.* at \*5-6.

41. *Id.* at \*5.

relationship as an owner from his prior dealings with the parties as a lender, and this led to the court of appeals' conclusion that no question of fact existed for the fourth and fifth factors.<sup>42</sup> Similarly, Phillips's failure to establish himself as an owner or partner thwarted Phillips's arguments relating to the second factor.<sup>43</sup> The outcome of the case most likely would have been different had Phillips insisted on the execution of a formal written partnership agreement.

### III. PERSONAL LIABILITY OF MEMBERS FOR FRAUDULENT TRANSFERS

In *Key v. Richards*,<sup>44</sup> the Austin Court of Appeals opined on the individual liability of members of a limited liability company in the context of a fraudulent transfer. PJC Properties, L.L.C. (PJC Properties), Steve Key (Key), Pat Curry (Curry), and PJC Central Texas Freight Lines, L.L.C. (collectively, Appellants) appealed a trial court judgment awarding damages to Prudence Adams and the court-appointed receiver for Centex Freight Lines, L.L.C. (Centex) (collectively, Appellees) jointly and severally against Curry, Key, and PJC Properties for a fraudulent transfer of Centex's assets.<sup>45</sup> The subject transaction involved a foreclosure and sale of assets from Centex to PJC Properties, which the trial court found to be fraudulent under the Uniform Fraudulent Transfer Act (UFTA), citing PJC Properties' lack of an enforceable security interest and Centex's failure to receive "reasonably equivalent value in exchange for the assets."<sup>46</sup> The Appellants objected to the trial court's decision to pierce the corporate veil to impose personal liability on Key and Curry, and argued that there was insufficient evidence to support the trial court's finding of a fraudulent transfer.<sup>47</sup>

The Appellants challenged the trial court's determination that PJC Properties had no security interest in Centex's property by contending that the Appellees' arguments negating the claimed security interest were based on "suspicion" and conjecture, not evidence, in an attempt to char-

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42. *Id.* at \*4-5.

43. *Id.* at \*4.

44. No. 03-14-00116-CV, 2016 WL 240773 (Tex. App.—Austin Jan. 13, 2016, no pet.) (mem. op.).

45. *Id.* at \*1.

46. *Id.* (citing TEX. BUS. & COM. CODE ANN. § 24.006(a) (West 2015)) ("A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.").

47. *Id.* The ownership of PJC Properties was structured such that, at the time of this decision, Curry and Key owned 99% and 1%, respectively, of PJC Properties, and PJC Centex was the wholly owned subsidiary of PJC Properties. Centex had ceased to be an active entity at the time of the decision but was previously wholly owned by Walkabout Transportation, LLC. The ownership of Walkabout Transportation, LLC was disputed and the company was either wholly owned by Curry or, according to Key's deposition, was owned 10% by an individual who was not a party to the suit, 41% by Key, and 49% by PJC Properties. *Id.* at \*1 n.1.

acterize a promissory note at trial as a “sham document.”<sup>48</sup> The court of appeals, however, disagreed and concluded that the evidence presented at trial was sufficient to find that PJC Properties did not have a security interest in the assets in question, and that the transfer was fraudulent.<sup>49</sup> In support of this determination, the court of appeals pointed to, among other things, Key’s statement that Centex’s property had not been “pledged as security for a debt”; the timing of filing of UCC financing statements that noted a security in all of Centex’s property; and Key’s deposition testimony that the only documents indicating that PJC Properties was a secured lender were the two UCC financing statements.<sup>50</sup> The court of appeals held that the evidence was sufficient for the jury to find that the claimed security interest was fraudulent.<sup>51</sup>

The Appellants further contended that the trial court improperly imposed liability on Key and Curry in their individual capacities by piercing the corporate veil.<sup>52</sup> The court of appeals, however, distinguished individual liability in the context of fraud from the “equitable doctrine of veil-piercing,” noting that under Texas law “an entity’s agent is personally liable for his own fraudulent or tortious acts.”<sup>53</sup> At trial, the jury found that the transfer was fraudulent, and that Key and Curry could be held individually “responsible for such tortious conduct[.]”<sup>54</sup> The court of appeals determined that, despite the similarity of the questions to the jury to the case law on veil-piercing, the trial court was not required to use the veil-piercing doctrine to find Key and Curry liable because Key and Curry had committed a tort, not because equity demanded a veil piercing.<sup>55</sup>

The court of appeals further noted that, although statutory law provides broad protection from individual liability for limited liability company members,<sup>56</sup> there has not been clear direction from the Texas Supreme Court on whether the current statutory protections countervail common law principles holding corporate agents liable for fraudulent conduct. Ultimately, the court of appeals “refuse[d] to hold that section 101.114 shields Key and Curry from their tortious fraudulent transfer under the circumstances in this case.”<sup>57</sup>

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48. *Id.* at \*1. The promissory note by Centex was payable to PJC Properties. Appellees claimed this note had been backdated.

49. *Id.* at \*2.

50. *Id.* (noting that the UCC financing statements were filed both prior to the filing of the initial suit and the day following the jury’s verdict in the first trial).

51. *Id.*

52. *Id.*

53. *Id.* (citing, among others, *Miller v. Keyser*, 90 S.W.3d 712, 717 (Tex. 2002); *Leyendecker & Assocs. v. Wechter*, 683 S.W.2d 369, 375 (Tex. 1984)).

54. *Id.* at \*3.

55. *Id.*

56. *Id.* at \*3 n.4 (citing TEX. BUS. ORGS. CODE ANN. § 101.114 (West 2012)) (“Except as and to the extent the company agreement specifically provides otherwise, a member or manager is not liable for a debt, obligation, or liability of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or order of a court.”).

57. *Id.*

In its review of the Appellants' final argument on sufficiency of the evidence supporting the imposition of individual liability on Key and Curry for their fraudulent conduct, the court of appeals found the Appellants' argument unpersuasive in light of the evidence presented.<sup>58</sup> Among other things, the court of appeals noted that Curry's control of PJC Properties and Key's role as president of Centex during the applicable time periods, as well as the acknowledged purpose of the foreclosure, which was to ensure that Prudence Adams could not collect on her judgment, sufficiently supported the jury's finding.<sup>59</sup> The judgment entered by the trial court was affirmed.<sup>60</sup> Justice Pemberton concurred with the majority's decision, but noted that he had reached his conclusion by invoking veil-piercing principles rather than individual liability for tortious conduct.<sup>61</sup>

This case is illustrative of the broad liability to which individuals expose themselves in the commission of fraudulent or tortious acts. Individuals cannot rely on the Texas statutory framework as an absolute shield for personal liability once their conduct rises to the level of fraudulent or tortious actions.

#### IV. PERSONAL LIABILITY OF MEMBERS OR MANAGERS UNDER AGENCY PRINCIPLES

In *Morello v. State of Texas*,<sup>62</sup> the Austin Court of Appeals explored the individual liability of a manager of a limited liability company under agency principles. Bernard Morello (Morello) appealed a trial court's grant of summary judgment in favor of the State of Texas (State) ordering Morello to pay civil fines of \$367,250.00 for alleged violations of rules of the Texas Commission on Environmental Quality (TCEQ) by White Lion Holdings, L.L.C. (White Lion), an entity managed and operated by Morello.<sup>63</sup> White Lion had purchased certain property on which five surface-water impoundments had created groundwater contamination and, at the time of the conveyance, the property was subject to a hazardous waste permit and compliance plan issued by the TCEQ governing the management, correction, and clean-up of the contamination.<sup>64</sup> The TCEQ transferred the permit and compliance plan to White Lion following the purchase.<sup>65</sup>

Several years later, the State sued White Lion on behalf of the TCEQ, claiming that White Lion had failed to follow the compliance plan, and the State's petition was eventually amended to also seek individual liabil-

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58. *Id.* at \*4.

59. *Id.*

60. *Id.* at \*5.

61. *Id.* at \*5-6.

62. No. 03-15-00428-CV, 2016 WL 2742380 (Tex. App.—Austin May 6, 2016, pet. filed) (mem. op.).

63. *Id.* at \*1-2.

64. *Id.*

65. *Id.* at \*2.

ity for Morello.<sup>66</sup> The State alleged that Morello and White Lion had failed to satisfy the requirements under the TCEQ's compliance plan, including a failure to provide financial assurance, submit reports for groundwater monitoring, repair or replace broken recovery wells, conduct weekly inspections, notify the TCEQ of "corrective action system shutdown," and other duties set forth in the compliance plan.<sup>67</sup> In its summary judgment motion, the State argued that Morello had "ensured that nothing would be done to comply with the terms, conditions, and limitations set forth in the Compliance Plan," including the payment of financial assurance.<sup>68</sup> Following a hearing and its review of the filings, the trial court granted summary judgment to the State and held Morello liable in his individual capacity for the alleged violations.<sup>69</sup>

One of Morello's assertions on appeal was that the State had established no legal basis on which to hold him individually liable for White Lion's alleged failure to comply with the compliance plan.<sup>70</sup> Since White Lion was a limited liability company, Morello argued that he could not be liable in his individual capacity unless either the veil of the company was pierced or his alleged wrongful conduct involved actions for which individual liability may be imposed upon an agent of a limited liability company, such as fraud.<sup>71</sup> The State contended that, although the duties and obligations under the permit and compliance plan had been transferred to White Lion and not to Morello personally, Morello should be individually liable for his actions as White Lion's decision maker.<sup>72</sup>

However, the State did not characterize its claims against Morello as tort or fraud-based, but instead described this as "a statutory enforcement action brought against Morello as operator and sole decision maker of White Lion."<sup>73</sup> The State argued that under the applicable provisions of the Texas Water Code, "[a] person may not cause, suffer, allow, or permit a violation of a statute within the commission's jurisdiction or a rule adopted or an order or permit issued under such a statute,"<sup>74</sup> and further that "[a] person who causes, suffers, allows, or permits a violation of a statute, rule, order, or permit" may be assessed a penalty.<sup>75</sup> According to the State, the statute's language providing for individual liability should serve as the basis for Morello's liability for White Lion's violations.<sup>76</sup> The State further contended that the common law principle of individual liability of a manager for tortious or fraudulent actions should

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66. *Id.* (The compliance plan required, among other things, that White Lion provide a \$574,000 financial assurance within six months following its purchase of the property.).

67. *Id.*

68. *Id.* at \*3.

69. *Id.*

70. *Id.*

71. *Id.* at \*3, \*5.

72. *Id.* at \*6.

73. *Id.*

74. *Id.* (citing TEX. WATER CODE ANN. § 7.101 (West 2008)).

75. *Id.* (citing TEX. WATER CODE ANN. § 7.102).

76. *Id.*

be expanded to also cover “wrongful acts.”<sup>77</sup> Since Morello purportedly caused White Lion’s violations of the compliance plan intentionally, the State claimed this conduct rose to the level of wrongful acts that create individual liability for the entity’s decision maker.<sup>78</sup> The State did not claim in its motion for summary judgment or elsewhere that it was seeking to pierce the corporate veil of White Lion, nor did it contend that Morello caused White Lion to commit fraud.<sup>79</sup>

In analyzing the arguments, the court of appeals noted that the Texas Limited Liability Company Act (Act) governed limited liability companies at the time Morello formed White Lion<sup>80</sup> and, prior to this case, the state legislature enacted the Business Organizations Code (Code), effective in January 2006, and the Code now governs the formation of limited liability companies.<sup>81</sup> Under both the Act and the Code, the court of appeals observed that the members and managers of limited liability companies are generally not liable for their company’s “debts, obligations or liabilities” unless specifically provided in the entity’s operating agreement.<sup>82</sup> The court of appeals further noted that, although statutes are silent, veil-piercing may possibly apply to limited liability companies in Texas in a manner comparable to the application of the same common law doctrine to corporations.<sup>83</sup> The court further emphasized that precedent exists in Texas for holding an agent liable “for his own fraudulent or tortious acts.”<sup>84</sup>

However, the court of appeals distinguished those exceptions from the State’s arguments. Here, the State did not assert that the violations of the compliance plan were tortious or fraudulent and instead confirmed “that the violations at issue [were] not torts[.]”<sup>85</sup> nor did the State cite to any recognizable veil-piercing theory under Texas law.<sup>86</sup> The State’s assertion that certain “wrongful acts” provide an independent or expanded basis for individual liability apart from veil-piercing, tort, or fraud claims when the applicable statute provides for individual liability was ultimately un-

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77. *Id.* at \*6–7. The court of appeals noted that each case cited in the State’s motion for summary judgment in support of its “wrongful acts” argument recites the principle that individual liability may be provided for corporate agents or employees for tortious or fraudulent acts, but no support is provided for individual liability for wrongful acts that are outside of those categories. *Id.* The court of appeals also noted in footnote 4 that “the cases that were cited in support for the proposition that the employee could be held ‘personally liable for the entity’s wrongdoing’ because he actively participated in the wrongdoing all recited the general rule of law that an employee may be held personally liable for his *tortious or fraudulent* acts that he committed during his employment.” *Id.* at \*7 n.4.

78. *Id.* at \*7.

79. *Id.* at \*5.

80. *Id.* at \*4; see Act of May 25, 1991, 72d Leg., R.S., ch. 901, § 46, 1991 Tex. Gen. Laws 3161, 3192–216 (as amended).

81. *Morello*, 2016 WL 2742380, at \*4; see TEX. BUS. ORGS. CODE ANN. §§ 402.001, 402.003, 402.005 (West 2012 & Supp. 2016) (describing the transition of the Code’s applicability to previously formed entities).

82. *Morello*, 2016 WL 2742380, at \*4.

83. *Id.*

84. *Id.* at \*7 (citing *Miller v. Keyser*, 90 S.W.3d 712, 717–18 (Tex. 2002)).

85. *Id.* at \*6–7.

86. *Id.* at \*5.

persuasive.<sup>87</sup> The court of appeals noted that Texas courts have not recognized “wrongful acts” as an independent category or an expansion of individual liability for tortious acts and instead emphasized that applicable precedent for such claims for “wrongful acts” involved tortious or fraudulent actions.<sup>88</sup> The court of appeals did not find support for individual liability beyond the scope of those categories.<sup>89</sup> As a result, the trial court’s grant of summary judgment was overturned because “the State failed to establish as a matter of law that Morello could be held individually liable for the alleged violations at issue,” and the case was remanded for further proceedings.<sup>90</sup>

This case was particularly interesting following the same court of appeals’ decision in *Key v. Richards*. In *Key*, the Austin Court of Appeals was willing to apply individual liability to members of a limited liability company in the context of a fraudulent transfer caused by those members.<sup>91</sup> In doing so, the court did not consider the statute which generally shields members from individual liability to be superior to the common law doctrine providing for individual liability for fraudulent acts, although the court noted a lack of clear guidance on the issue from the legislature and the Texas Supreme Court.<sup>92</sup> Here, the court declined to expand the scope of actions giving rise to individual liability beyond the scope of veil-piercing and fraud or tort, noting that the State’s “wrongful actions” claim serves as a subset of the existing bases for individual liability and is not a viable, separate basis for such claims.<sup>93</sup>

#### V. ADMISSION OF AN ESTATE’S REPRESENTATIVE AS LIMITED PARTNER; DIRECT VS. DERIVATIVE CLAIMS

The San Antonio Court of Appeals examined the admission of a legal representative of a limited partner’s estate as a limited partner and whether certain claims are direct or derivative in nature in *Shurberg v. La Salle Industries*.<sup>94</sup> Rebecca Lord (Lord) was a limited partner in La Salle Industries Limited, a limited partnership (La Salle LP).<sup>95</sup> The general partner of La Salle LP was La Salle Industries, Inc. (La Salle Industries), which was controlled by relatives of Lord, Roy Martin (Roy) and his

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87. *Id.* at \*6–7.

88. *Id.* at \*7–8.

89. *Id.* at \*7.

90. *Id.* at \*9.

91. *Key v. Richards*, No. 03-14-00116-CV, 2016 WL 240773, at \*4 (Tex. App.—Austin Jan. 13, 2016, no pet.) (mem. op.).

92. *Id.* at \*3 n.4 (citing TEX. BUS. ORGS. CODE ANN. § 101.114 (West 2012)); see also notes 56–57 and accompanying text.

93. *Morello*, 2016 WL 2742380, at \*7.

94. No. 04-15-00320-CV, 2016 WL 1128291, at \*3–4, \*6–9 (Tex. App.—San Antonio Mar. 23, 2016, no pet.) (mem. op.).

95. *Id.* at \*1. The original name of La Salle LP had been La Salle Industries, a Limited Partnership, but this was changed to the current entity name in 2009.

wife, Elizabeth Martin (Elizabeth) (together, the Martins).<sup>96</sup> Both La Salle LP and La Salle Industries were created by Charles Lord, and these entities were structured so that his nieces and nephews would hold the ownership interests.<sup>97</sup> Following Charles Lord's death, Roy began to liquidate La Salle LP's assets. Lord wrote two letters to Roy voicing concerns about the status and transparency of La Salle LP's operations.<sup>98</sup> Lord died in 2012 and her husband, Jonathan Shurberg (Shurberg), was appointed as representative of her estate.<sup>99</sup>

Shurberg sued La Salle LP, the Martins, and Roy G. Martin Jr. Property Management, Inc. (Property Management, Inc.). The claims included, among other things, mismanagement of La Salle LP, a demand to remove La Salle Industries as general partner of La Salle LP, a demand for an accounting, and a demand for access to La Salle LP's books and records.<sup>100</sup> The remaining limited partners of La Salle LP were later joined as defendants in the proceedings (together with La Salle LP, the Martins, and Property Management, Inc., Defendants).<sup>101</sup> The Defendants claimed Shurberg did not have standing to sue because the action was based on derivative claims, and Shurberg had not been admitted as a limited partner to La Salle LP.<sup>102</sup> The trial court agreed with the Defendants and dismissed Shurberg's claims. Shurberg appealed, arguing that he was a limited a partner of La Salle LP as personal representative of Lord's estate and that many of his claims were direct instead of derivative.<sup>103</sup> The Defendants also asserted that the trial court lacked subject matter jurisdiction for the same reasons the Defendants argued Shurberg lacked standing.<sup>104</sup> The Defendants further claimed that Shurberg was merely an assignee of Lord's limited partnership interest rather than a limited partner of La Salle LP.<sup>105</sup>

Shurberg's claim asserting status as a limited partner consisted of three elements: (1) the language of Section 153.113 of the TBOC; (2) the La Salle LP operating agreement; and (3) the conduct of La Salle Industries and the other limited partners.<sup>106</sup> The relevant provision of the TBOC provides:

If a limited partner who is an individual dies . . . the limited partner's . . . legal representative may exercise all of the limited partner's rights and powers to settle the limited partner's estate or administer the limited partner's property, including the power of an assignee to

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96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.* at \*2.

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.* at \*3.

105. *Id.*

106. *Id.*

become a limited partner under the partnership agreement.<sup>107</sup>

Shurberg argued that his right to exert all of the limited partner's rights and powers to settle the estate automatically admitted him as a limited partner of La Salle LP.

In analyzing the first prong of Shurberg's claim, the court of appeals noted that no case law exists constructing Section 153.113.<sup>108</sup> In its review of the statute's language and the plain meaning of its words, the court reasoned that the phrase "including the power of an assignee to become a limited partner under the partnership agreement" indicated that Shurberg did not automatically become a limited partner of La Salle LP as a representative of Lord's estate, and instead the statute allows him to become a limited partner only if expressly permitted under La Salle LP's partnership agreement.<sup>109</sup>

Next, the court of appeals examined the La Salle LP partnership agreement in connection with the second prong of Shurberg's claim. Shurberg cited the successors and assigns provision in the partnership agreement as support for his admission as a limited partner, which reads as follows: "This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective heirs, executors, administrators, legal representatives, successors and assigns where permitted by this Agreement."<sup>110</sup> The court noted that, although this language binds an assignee or successor to the terms of the limited partnership agreement, it does not provide that the assignee or successor is admitted or becomes a limited partner.<sup>111</sup> Further, the court emphasized that the agreement's assignment provision expressly states that an assignee is not automatically entitled to admission as a limited partner.<sup>112</sup>

For the third and final prong of Shurberg's claim that he had been admitted as a limited partner, the court of appeals looked to the conduct of the general partner (La Salle Industries) and the other limited partners.<sup>113</sup> Shurberg argued that the other limited partners had consented to his admission as a limited partner in La Salle LP.<sup>114</sup> The court noted that the partnership agreement was silent with respect to the method of admission for a limited partner and agreed with Shurberg that Texas law permits an assignee of a limited partner's interest to be admitted if all partners consent to such admission.<sup>115</sup> However, the court disagreed with Shurberg that the other partners had consented, pointing specifically to

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107. *Id.* (citing TEX. BUS. ORGS. CODE ANN. § 153.113 (West 2012)).

108. *Id.*

109. *Id.* at \*4 (quoting § 153.113).

110. *Id.*

111. *Id.*

112. *Id.* at \*4-5.

113. *Id.* at \*5-6.

114. *Id.* at \*5.

115. *Id.* (citing TEX. BUS. ORGS. CODE ANN. § 153.253(a) (West 2012)) ("An assignee of a partnership interest . . . may become a limited partner if and to the extent that: (1) the partnership agreement provides; or (2) all partners consent.").

the conduct of Roy.<sup>116</sup> Roy had requested Lord's probate information in order to confirm that Shurberg had authority as representative and, although Roy had also asked Shurberg for his contact information so he could update La Salle LP's records, the court concluded that the evidence indicated that Roy's conduct may have acknowledged that Shurberg owned a partnership interest.<sup>117</sup> However, the court determined there was no evidence that Roy had actually consented to Shurberg becoming a limited partner.<sup>118</sup> Similarly, the court also determined there was no evidence that any of the other limited partners had consented to Shurberg becoming a limited partner, distinguishing the limited partners' behavior treating Shurberg, as Lord's spouse, like a limited partner from those limited partners actually consenting to Shurberg becoming a limited partner.<sup>119</sup> Ultimately, the court of appeals found there was no issue of fact as to whether Shurberg was a limited partner of La Salle LP, and all three prongs of Shurberg's argument relating to this issue failed.<sup>120</sup>

Concluding that Shurberg had not been admitted as a limited partner, the court of appeals moved on to analyze his next argument: that Shurberg's claims for (1) an accounting; (2) access to books and records; (3) removal of the general partner; and (4) application for injunctive relief, temporary restraining order, and the appointment of a receiver were direct claims and not derivative.<sup>121</sup> Since Shurberg was not a limited partner, he could only sue for direct claims, meaning those where "the wrongdoer violates a duty that arises from a contract or otherwise that is owed directly by the wrongdoer to the stakeholder."<sup>122</sup> On the other hand, only limited partners may bring derivative claims, which allow a limited partner to sue in the name of the partnership so that each limited partner and the partnership itself may be made whole.<sup>123</sup>

In its analysis of Shurberg's accounting claim, the court of appeals noted that an accounting claim is considered derivative if it is brought as part of another derivative action.<sup>124</sup> Here, Shurberg demanded an accounting "in order to ascertain the amount due to the limited partners, including the Estate"<sup>125</sup> as a result of the damage alleged under his breach of fiduciary duty claim.<sup>126</sup> Since the breach of fiduciary duty claim was undisputed as derivative, the court concluded that the accounting

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116. *Id.* at \*5–6.

117. *Id.* at \*5.

118. *Id.*

119. *Id.* at \*6.

120. *Id.*

121. *Id.* at \*7 (noting that Shurberg's other claims for breach of fiduciary duty, negligent misrepresentation, fraud, and breach of contract were derivative, which neither party disputed.).

122. *Id.* (citing *Swank v. Cunningham*, 258 S.W.3d 647, 661 (Tex. App.—Eastland 2008, pet. denied)).

123. *Id.* at \*6–7 (citing *Swank*, 258 S.W.3d at 661).

124. *Id.* at \*8.

125. *Id.* at \*9.

126. *Id.*

claim was also derivative.<sup>127</sup>

The court of appeals also assessed Shurberg's claim for access to books and records of La Salle LP, noting that the Defendants agreed that Shurberg's claim was direct.<sup>128</sup> However, the Defendants contended that no justiciable controversy existed for this claim since Shurberg had already been granted access to the books and records and remained free to access them again.<sup>129</sup> The court agreed that, since Shurberg had previously been granted access and maintained the right to inspect those books and records in the future, no justiciable controversy existed with respect to this claim.<sup>130</sup>

In examining Shurberg's third and fourth claims, the court of appeals looked to whether the injuries allegedly suffered by Shurberg were distinct from those injuries allegedly suffered by La Salle LP, noting that no "separate and independent right" existed to bring these claims if the injury was the same.<sup>131</sup> The court further emphasized that these claims derived from Shurberg's breach of fiduciary duty claim and that Shurberg failed to describe injuries distinct from those suffered by La Salle LP in his live pleading.<sup>132</sup> As a result, the court determined that Shurberg's third and fourth claims were derivative.<sup>133</sup>

Ultimately, the court of appeals held that Shurberg was not a limited partner in La Salle LP and he lacked standing to file all claims against the Defendants, except for the claim relating to access to books and records.<sup>134</sup> The access claim, however, was not a justiciable controversy.<sup>135</sup> The court of appeals affirmed the trial court's decision.<sup>136</sup>

*Shurberg v. La Salle Industries Limited* provides valuable guidance concerning Section 153.113 of the TBOC, establishing that an estate's representative is not automatically admitted as a limited partner.<sup>137</sup> Texas estate representatives should be aware that, unless the partnership agreement expressly provides for admission of the representative as a limited partner without action by the other partners, the representative will not automatically be characterized as a limited partner under the TBOC.<sup>138</sup>

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127. *Id.* at \*7, \*9.

128. *Id.* at \*8.

129. *Id.*

130. *Id.*

131. *Id.* (citing *Swank v. Cunningham*, 258 S.W.3d 647, 661–62 (Tex. App.—Eastland 2008, pet. denied)).

132. *Id.*

133. *Id.*

134. *Id.* at \*6, \*9.

135. *Id.* at \*8, \*9.

136. *Id.* at \*9.

137. *Id.* at \*4–5.

138. *See id.*

## VI. PURPOSE CLAUSES AND AUTHORITY OF LIMITED PARTNER

The Texas Supreme Court recently overturned a decision by the Corpus Christi Court of Appeals interpreting the scope of a broadly drafted purpose clause in an entity's operating agreement, restoring limitations on the liability of upstream owners for the negligent acts of members and limited partners in certain circumstances.<sup>139</sup> In *Doctors Hospital at Renaissance, Ltd. v. Andrade*, the supreme court addressed the question of whether a limited partnership owning a hospital, or the partnership's general partner, may be held vicariously liable for the negligence of a doctor who is also a limited partner.<sup>140</sup> Last year, the court of appeals held that the limited partnership's purpose clause was so broadly drafted that a jury could find that a limited partner/physician's medical negligence was committed in the ordinary course of the partnership's business.<sup>141</sup> The court of appeals' ruling was a cause of some concern for drafters of partnership agreements, given that many purpose clauses are drafted in very broad terms and without consideration for the implications of the specific language used. In particular, hospitals where practicing physicians were also investors had reason to fear the potential for new and unanticipated liability for medical malpractice claims after the decision from the court of appeals. The supreme court, however, reached a different conclusion on the scope of the partnership's purpose clause, holding that the doctor's medical treatment of a patient was outside of the ordinary course of the partnership's business as a matter of law, despite the generic language of the purpose clause in the partnership agreement.<sup>142</sup> Therefore, the supreme court's decision precluded the injured parties from seeking damages from the partnership owning the hospital for the negligent actions of the limited partner/physician.<sup>143</sup>

The controversy arose when Jesus Jaime Andrade and Jessica Andrade (together, the Andrades) alleged that their doctor, Rodolfo Lozano (Doctor Lozano), negligently delivered their daughter Julianna, resulting in permanent injury to the child.<sup>144</sup> The delivery had been complicated by the fact that one of the baby's shoulders had been unable to pass through the birth canal. Doctor Lozano was alleged to have "engaged in excessive twisting" to free the shoulder and deliver the child, resulting in permanent nerve damage to the child's arm.<sup>145</sup> The Andrades sought to recover damages from the limited partnership that owned the hospital where the child was born (Hospital LP), and from the limited liability company that served as the general partner of Hospital LP (GP LLC), under the theory

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139. *Doctors Hosp. at Renaissance, Ltd. v. Andrade*, 493 S.W.3d 545, 546–47 (Tex. 2016).

140. *Id.* at 546.

141. *Id.* at 547.

142. *Id.* at 548.

143. *See id.* at 551.

144. *Id.* at 546.

145. *Id.*

that Hospital LP and GP LLC were vicariously liable for Doctor Lozano's negligence since he was acting in his capacity as a limited partner of Hospital LP.<sup>146</sup>

In the trial court, Hospital LP and GP LLC moved for summary judgment on the grounds that even if Doctor Lozano had committed negligence, the partnership could not be liable for his conduct because he was not acting in the ordinary course of the partnership's business or with the authority of the partnership to the extent that he was providing medical services to patients.<sup>147</sup> The trial court denied the partnership's motion for summary judgment but granted an immediate interlocutory appeal on the issue.<sup>148</sup> The court of appeals read Hospital LP's partnership agreement in the same way as the trial court and upheld its decision to deny summary judgment, finding that the purpose clause contained in the partnership agreement was so broadly drafted as to raise a question of fact on the issue of whether Doctor Lozano was acting within the scope of the partnership and/or with the partnership's authority.<sup>149</sup> The purpose clause in Hospital LP's partnership agreement stated that the purpose of the partnership was:

- (i) to develop, construct and operate such Health Care Facilities as the General Partner may deem appropriate from time to time; (ii) prior to the Spin-Off, to own an interest in DHR Real Estate [Partners, Ltd.] and DHR [Real Estate Management, L.L.C.]; (iii) to own, develop, operate and engage in such other business activities as the General Partner may deem appropriate from time to time; and (iv) to enter into, make and perform all such agreements and undertakings, and to engage in all such activities and transactions, as the General Partner may deem necessary or appropriate for or incidental to the carrying out of the foregoing objects and purposes.<sup>150</sup>

A reading of the partnership's purpose clause seems to indicate the drafter's specific intention to authorize the general partner to "develop, construct and operate" hospitals, and to have an ownership interest in a subsidiary entity prior to an anticipated "spin-off."<sup>151</sup> While it seems unlikely that the entity responsible for developing and constructing a health care facility would then be expected to "operate" such a facility at the level of delivering babies, the "catch-all" language that follows seems to authorize the partnership to engage in any other business activities that the general partner chooses.<sup>152</sup> The purpose clause of GP LLC's operating agreement was even broader, stating that

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146. *Id.*

147. *Id.* at 546-47; *see also* TEX. BUS. ORGS. CODE ANN. § 152.303 (West 2012) (defining the scope of a partnership's liability).

148. *Andrade*, 493 S.W.3d at 547.

149. *Id.* at 547; *Doctors Hosp. at Renaissance, Ltd. v. Andrade*, No. 13-15-00046-CV, 2015 WL 3799425, at \*7 (Tex. App.—Corpus Christi June 18, 2015), *rev'd*, 493 S.W.3d 545, 551 (Tex. 2016).

150. *Andrade*, 493 S.W.3d at 548.

151. *See id.*

152. *See id.*

[t]he purpose for which this limited liability company is organized is to transact any and all lawful business for which limited liability companies may be organized under the laws of Texas, including, but not limited to, the following: . . . [t]o buy, rent, sell, manufacture, produce, assemble, distribute, repair, and service any and all products or services in which the company desires to engage[.]<sup>153</sup>

Therefore, if the Andrades could show that Hospital LP was liable for Doctor Lozano's negligence, they could easily argue that Hospital LP was acting in the normal course of GP LLC's business, thereby exposing an additional upstream entity to liability on their negligence claim.<sup>154</sup>

The court of appeals sided with the Andrades, concluding that under the terms of the partnership agreement, the scope of permissible activities in which Hospital LP might engage was very broad, and could not be said as a matter of law to exclude the practice of medicine.<sup>155</sup> Given that the partnership agreement contained generic "purpose clause" language but did not include a provision specifically authorizing limited partners to practice medicine as part of the partnership's business, the court of appeals' ruling had the potential to subject similarly situated hospitals to a new and unanticipated source of liability—i.e., from lawsuits arising from medical malpractice claims against doctors who are also investors in the facility itself. While the decision had the potential to provide patients with medical negligence claims with additional sources of recovery for their damages, the imposition of this additional and unanticipated liability on partnerships in the healthcare business also had the potential to increase the costs of operating such partnerships, which in turn could increase the cost and availability of healthcare in general.

In overturning the decision of the court of appeals, the supreme court concluded that the permitted scope of Hospital LP's business as set forth in the partnership agreement, however broad, excluded the practice of medicine.<sup>156</sup> In reaching this conclusion, the supreme court focused on provisions of the partnership agreement indicating that it was to be construed in accordance with Texas law, and that Texas law would govern in the event of a conflict between the terms of the partnership agreement and Texas law.<sup>157</sup> Because Texas law permits only natural persons, not partnerships, to be licensed to practice medicine, the partnership agreement would have to be interpreted to include "the unlawful practice of medicine" among Hospital LP's permitted activities in order for Doctor Lozano's conduct to fall within the ordinary scope of the partnership's business.<sup>158</sup> Therefore, the supreme court interpreted the partnership agreement's purpose clause to exclude the practice of medicine, meaning that Doctor Lozano's negligent treatment of the Andrades' child could

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153. *Doctors Hosp.*, 2015 WL 3799425, at \*5 n.5.

154. *See id.* at \*1.

155. *Id.* at \*7.

156. *Andrade*, 493 S.W.3d at 551.

157. *Id.* at 548.

158. *Id.*

not be within the ordinary course of Hospital LP's business.<sup>159</sup>

Lastly, the supreme court briefly analyzed the Andrades' contention that Hospital LP was liable for the actions of Doctor Lozano even if his actions were not within the ordinary course of the partnership's business because he was acting "with the authority of the partnership."<sup>160</sup> While it is true that Texas law provides that a partnership is liable for the acts of a partner acting with the partnership's authority, the supreme court held that Doctor Lozano's medical treatment of the Andrades was not performed with such authority.<sup>161</sup> The supreme court noted that "[t]he partnership agreement is the source of authority" for the partnership, setting forth the management structure of the partnership and the role of limited partners in partnership affairs, if any.<sup>162</sup> In this case, Hospital LP's partnership agreement expressly prohibited limited partners from acting on behalf of the partnership unless specifically authorized to do so elsewhere in the partnership agreement.<sup>163</sup>

Drafters of partnership agreements often use broadly drafted purpose clauses in their partnership agreements in order to impart a greater degree of flexibility in conducting the partnership's business, and to make clear that the partnership has the necessary authority under its organizational documents to undertake such business activities.<sup>164</sup> Although the supreme court in this case has drawn a limitation on the extent to which a broadly drafted purpose clause can impose liability on a partnership for the actions of its limited partner, it is important to note that the applicability of the supreme court's decision in future cases may prove to be confined to the area of medical negligence. It is therefore crucial for drafters of partnership agreements to carefully tailor a partnership's purpose clause to impart the desired degree of flexibility for the partnership's business activities, while at the same time expressly excluding activities intended to be outside the scope of the partnership's business, and which, if engaged in by a limited partner, could otherwise be attributed to the partnership and therefore expose it to unanticipated liabilities.

## VII. DIVORCE AND PARTNERSHIP PROPERTY

In *In re K.R.C.*,<sup>165</sup> the Dallas Court of Appeals offered some clarification on the circumstances in which partnership assets may be reached in order to satisfy a divorce judgment against a limited partner. Together, husband and wife owned 100% of Aecium, a limited partnership in the

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159. *Id.* at 549, 551.

160. *Id.* at 550–51.

161. *Id.* See TEX. BUS. ORGS. CODE ANN. § 152.303(a)(2) (West 2012) for the applicable statute.

162. *Andrade*, 493 S.W.3d at 550.

163. *Id.*

164. See *id.* at 550–51.

165. No. 05-13-01419-CV, 2015 WL 7731784 (Tex. App.—Dallas Dec. 1, 2015, pet. denied) (mem. op.).

business of selling medical billing software and services.<sup>166</sup> The couple had been married in 1999.<sup>167</sup> Things seemed to go well until about 2007 or 2008, when the husband and an Aecium employee developed a sexual relationship and the husband, in 2009, caused the partnership to give the employee an 80% raise.<sup>168</sup> The husband continued to cause the partnership to pay his mistress an exorbitant salary through 2010, when husband and wife separated and the wife filed for divorce.<sup>169</sup>

In light of these events, the wife petitioned the trial court for a disproportionately large share of the community assets. She alleged that the husband caused the marriage to fail by committing adultery, fraud on the community, and waste of community assets by siphoning assets to his mistress.<sup>170</sup> Two business appraisers testified at trial that the husband had indeed caused the partnership to overpay the employee by approximately \$150,000 over the course of their two-year affair.<sup>171</sup> In particular, the wife requested that the trial court “reconstitute the community estate” by clawing back funds from the husband in an amount equal to the amount by which the partnership overpaid the mistress, plus the amount of a loan that the partnership made to the mistress for repairs to her home.<sup>172</sup> The trial court granted most of the wife’s requests, declaring the husband guilty of adultery and awarding her an “equalization payment” in the amount of \$347,000, which included \$195,000 for the excessive payments that were paid to the mistress in the form of a salary from the partnership.<sup>173</sup>

But was it *their* money that the husband had been siphoning to his mistress, or was it partnership property that Aecium had paid to its employee? The husband, perhaps not surprisingly, argued for the latter interpretation.<sup>174</sup> He objected to the trial court’s equalization payment to his wife on this and other grounds, arguing that the trial court was wrong to award his wife the \$195,000 representing excessive salary paid by the partnership to his mistress since partnership assets are not community property, and because a limited partner has no right to specific partnership assets.<sup>175</sup> In support of his position, the husband relied in part on another Texas divorce case, *Lifshutz v. Lifshutz*.<sup>176</sup> In *Lifshutz*, the wife in a divorce proceeding asked the court to pierce the corporate veil of her husband’s companies in order to include specific partnership assets in its

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166. *Id.* at \*1.

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.* The amount calculated by the appraisers did not include overpayments made by the partnership to the employee in 2012.

172. *Id.* at \*1–2. The wife also requested repayment of other amounts, including money spent to repair the husband’s jet ski.

173. *Id.* at \*2.

174. *Id.* at \*4.

175. *Id.*

176. 61 S.W.3d 511 (Tex. App.—San Antonio 2001, pet. denied).

valuation of the community estate.<sup>177</sup> In that case, the San Antonio Court of Appeals held that a court may not award specific partnership assets to the wife because partnership assets are not community property.<sup>178</sup>

The Dallas Court of Appeals disagreed, noting that the facts of *Lifshutz* differed from this case in significant ways.<sup>179</sup> The court of appeals focused on the fact that in *Lifshutz*, the husband acquired his partnership interests before marrying his wife, making such partnership interests his separate property.<sup>180</sup> Furthermore, the wife in *Lifshutz* was not a partner in the partnership.<sup>181</sup> Here, husband and wife were both partners, owning 100% of the outstanding partnership interests in Aecium.<sup>182</sup> Therefore, unlike in *Lifshutz*, the wife in this case was not a third party seeking to pierce the veil of a partnership, but rather a 50% limited partner seeking to claw back the assets of a partnership that another limited partner fraudulently conveyed out of the partnership to his mistress.<sup>183</sup> Therefore, the court of appeals concluded, when the husband caused the partnership to pay his mistress an excessive salary, he effectively used the partnership to drain funds from the community estate.<sup>184</sup> It was therefore within the trial court's discretion to award the wife an amount equal to the partnership funds that the partnership paid to the mistress in the form of excessive salary.<sup>185</sup>

#### VIII. CREDITORS' REMEDIES AGAINST A PARTNER

In *Spates v. Office of the Attorney General*,<sup>186</sup> the Fourteenth Houston Court of Appeals explored the question of whether the State of Texas may reach the assets of a limited liability company in order to collect unpaid child support judgments from a member of such limited liability company. Christopher Spates was the sole member of Prodigy Services, LLC (Prodigy), the father of three children by three different mothers, and the subject of three outstanding child support judgments totaling over \$94,000.<sup>187</sup> Prodigy was the plaintiff in a lawsuit against a company called Eni US Operating Company (Eni), seeking damages for breach of contract and tortious interference with contract.<sup>188</sup> Mr. Spates was deposed at one point in connection with the proceedings, but was not himself a party to the case.<sup>189</sup> Immediately after Spates was deposed, the Child Support Division of the Office of the Attorney General (OAG)

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177. *In re K.R.C.*, 2015 WL 7731784, at \*5.

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.*

183. *Id.*

184. *Id.*

185. *Id.*

186. 485 S.W.3d 546, 548 (Tex. App.—Houston [14th Dist.] 2016, no pet.).

187. *Id.* at 548–50, 549 n.2.

188. *Id.* at 548.

189. *Id.* at 548–49.

intervened in the case, seeking to satisfy each of the three child support judgment liens against Spates from the proceeds of any award that Prodigy might receive in its suit against Eni.<sup>190</sup> Before intervening in the Prodigy case, the OAG had searched diligently for any other assets of Spates from which to satisfy the child support judgments, and had found nothing.<sup>191</sup> It is unclear from the record whether Spates had cleverly hidden his assets or was actually broke—but in either case, Prodigy's lawsuit and the potential award arising therefrom represented the OAG's best chance of collecting any unpaid child support from Spates.

Shortly after the OAG's appearance, Prodigy and Eni reached a settlement agreement to pay Prodigy \$257,500, which amount Eni deposited with the trial court registry.<sup>192</sup> As the sole member of Prodigy, Spates could have anticipated a distribution of the cash award out to himself, if not for the well-timed appearance of the OAG. At this point, the trial court refused to order the release of the \$257,500 to Prodigy, and granted the OAG's request for a charging order against Spates's membership interest in Prodigy.<sup>193</sup> The charging order also listed the home address and amount of unpaid child support Spates owed to each child's mother.<sup>194</sup> Spates and Prodigy immediately appealed the trial court's decision on a number of grounds, including (i) that the trial court lacked the necessary personal jurisdiction over Spates, who was not a party to the case; and (ii) that the OAG did not follow the procedures necessary to obtain a charging order.<sup>195</sup>

Before addressing Spates and Prodigy's arguments on appeal, the court of appeals announced that it would first address whether it had jurisdiction to hear Spates's arguments, despite the fact that no party contested the court's jurisdiction.<sup>196</sup> The court noted that Spates was not a party to the trial court action, and had made no attempt to intervene in the proceedings when the OAG made its appearance and moved to enforce the child support judgments.<sup>197</sup> The court of appeals further noted that Spates's status as a member of Prodigy did not in itself give him standing to appeal the trial court's decision.<sup>198</sup> And because Spates himself failed to make any argument that he had standing to appeal the trial court's order—arguing, to the contrary, that the trial court had insufficient jurisdiction over him to allow the OAG's intervention in the trial court—the court of appeals dismissed Spates's appeal, leaving Prodigy itself to bring the appeal.<sup>199</sup>

Prodigy, for its part, sought to overturn the trial court's order on two

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190. *Id.*

191. *Id.* at 555–56.

192. *Id.* at 549.

193. *Id.*

194. *Id.* at 550.

195. *Id.*

196. *Id.*

197. *Id.*

198. *Id.*

199. *Id.* at 550–51.

grounds.<sup>200</sup> First, Prodigy challenged the trial court's jurisdiction over Spates and over child support matters generally, arguing that the respective family courts in which each of the three mothers had obtained their child support judgments had continuing, exclusive jurisdiction over the parties and the child support matters.<sup>201</sup> Prodigy also focused on the fact that the child support judgments were against Spates personally, who was not a party to the case in the trial court, and whose status as a member of Prodigy, a limited liability company, did not give him a claim to any specific assets owned by such entity.<sup>202</sup>

The court of appeals rejected all of Prodigy's arguments, holding that the trial court had jurisdiction to hear the OAG's motion and to grant the charging order.<sup>203</sup> The court of appeals concluded that the trial court did not need to make Spates a party to the case in order to have jurisdiction to issue the charging order requested by the OAG, noting that the TBOC "does not require that the judgment debtor be made a party" to a case before a judgment creditor is permitted to enter a motion for a "charging order against the debtor's membership interest in the limited liability company."<sup>204</sup> Further, the court of appeals noted that the charging order was directed at Prodigy, not Spates, and in fact did not impose any obligations on Spates at all.<sup>205</sup> Rather, the charging order had the effect of obligating Prodigy to disregard the distribution provisions in its operating agreement, and instead to pay any distributions to the State of Texas up to the full amount of the child support judgments.<sup>206</sup> For the same reason, the court of appeals concluded that the charging order did not entitle the OAG to obtain any specific partnership assets, as Spates and Prodigy had argued.<sup>207</sup> In effect, the trial court granted the OAG a lien on Spates's membership interest in Prodigy.<sup>208</sup> While a lien against Spates's membership interest in Prodigy may have been the OAG's best chance to force Spates to pay child support, it is important to note the inherent limitations of the remedy. The charging order did not grant the OAG the right to foreclose on its interest in the distributions from Prodigy, nor did the OAG have any other legal or equitable rights with respect to Prodigy's assets (including the \$257,500 award from Eni).<sup>209</sup> Spates himself retained control of Prodigy in his capacity as sole member, and he could not be compelled to cause Prodigy to make a distribution.<sup>210</sup> In this particular case, however, refusing to declare a distribution out of spite would be a costly move for Spates, since the interest on the child support judgments

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200. *Id.* at 554.

201. *Id.*

202. *Id.*; see also TEX. BUS. ORGS. CODE ANN. § 101.106(b) (West 2012).

203. *Spates*, 485 S.W.3d at 556.

204. *Id.*

205. *Id.*

206. *Id.*

207. *Id.*

208. See TEX. BUS. ORGS. CODE ANN. § 101.112(c) (West 2015).

209. *Spates*, 485 S.W.3d at 556.

210. *Id.*

would continue to grow, and Spates would have to forego receiving the balance of the \$257,500 award indefinitely.

#### IX. CONCLUSION

On the whole, the cases from this Survey period emphasize the theme that a drafter's word choice in the partnership agreement can play a critical role in determining the rights and responsibilities of the partners. Drafters must carefully select the language of each partnership provision in order to allocate liabilities among the partners in a predictable way. Other cases reflect a longstanding interest in preserving the limited liability protection conferred upon members and partners of limited liability companies and limited partnerships formed under Texas law. At the same time, in cases where partners have committed fraud or otherwise acted in bad faith with respect to partnership assets, the courts have shown an enthusiasm for resolving statutory ambiguities against such partners in order to maximize the ability of creditors and other interested parties to reach partnership assets—perhaps an indication that the courts believe the remedies available in such circumstances are too limited. Further, attorneys must consider and account for ambiguities in the TBOC that may affect their clients' rights and remedies in the event of litigation. Lastly, a common takeaway in nearly every case is that the provisions commonly considered "boilerplate" in partnership agreements should be considered as part of the overall scheme of partnership operations, balancing flexibility to conduct partnership business with practical limitations on the authority of the partners in order to guard against unanticipated liabilities.