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Partnership Law

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I. INTRODUCTION

During the survey period, Texas courts amplified the importance of carefully drafting and structuring joint venture relationships. Specifically, Texas courts continued to generally show deference to juries' finding of partnership formation, even if the basis for the formation of the partnership is merely the actions and words of the parties. Another broad theme of the cases from this survey period was the importance of careful pleadings over the course of an adjudication, as many of the outcomes during the survey period hinged on such procedural actions. This article is di-

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vided into five main sections that review cases covering the following topics: (I) partnership formation; (II) breach of partners' duties, including fiduciary and disclosure duties; (III) personal liability of members or managers under veil-piercing principles; (IV) derivative claims; and (V) creditors' remedies against a partner.

II. FORMATION OF PARTNERSHIP

A. De Facto Partnership Formation

In *In re Hernandez*,[1] the U.S. Bankruptcy Court for the Western District of Texas illustrated the circumstances in which a de facto partnership is formed.

Jorge Quiroz Hernandez (Hernandez) and Alejandro Quiroz-Pedrazzi (AQP) owned and operated three frozen yogurt stores in Mexico from 2009 to 2014.[2] Hoping to expand into the United States, Hernandez and AQP formed three Texas limited liability companies: (1) Global Q Investments, LLC (Global Q); (2) San Antonio Orange Cup, LLC (SA Orange Cup); and (3) Grupo 2+2, LLC (Grupo). By October 2011, Global Q and SA Orange Cup had both entered into leases for store locations in the United States.[3]

Magdalena Lopez (Lopez) met Hernandez in May 2012 and began discussing the possibility of Lopez investing in the Orange Cup stores.[4] Lopez requested financial information on Global Q and SA Orange Cup but, without receiving all the requested information, signed a subscription agreement (the Subscription Agreement) committing Lopez to purchase 20% of Global Q for $400,000.[5] The Subscription Agreement provided that Lopez would lend $200,000 to Global Q with the option to contribute the loan receivable to Global Q as a portion of her total commitment, paying the remaining $200,000 in cash.[6] After signing the Subscription Agreement, Lopez loaned Global Q $200,000 in exchange for a promissory note. Both Grupo, a shell company formed by Hernandez to hold his interest in Global Q, and Hernandez, individually, guaranteed the repayment of the note.[7]

For the next year, Lopez, Hernandez, and AQP held company meetings, making decisions about the business, including the opening of three stores.[8] Lopez continued to request financial information, which Her-

1. 565 B.R. 367 (Bankr. W.D. Tex. 2017).
2. *Id.* at 372. The three stores each faced different challenges during this time period. One store in Monterrey, Mexico, was only open for part of 2010 due to high crime in the area. Another store was only open from 2009 to 2014. *Id.*
3. *Id.*
4. *Id.* at 373.
5. *Id.* The financial information was intended to be attached to the Subscription Agreement. Although disputed, the court determined that it was not attached to the Subscription Agreement at the time of execution. *Id.* The Subscription Agreement was countersigned by Hernandez, individually and on behalf of Grupo, and AQP. *Id.*
6. *Id.* at 374.
7. *Id.*
8. *Id.* at 374–75.

nandez failed to provide.[9] Even though Lopez did not receive any reports or cash flow statements, she continued to fund loans documented by promissory notes and cash calls totaling $671,270.00.[10] The stores never turned a profit and were all shuttered by June 2013.[11]

Without first demanding repayment of the promissory notes, Lopez filed suit against Hernandez, AQP, Grupo, and Global Q in Texas state court and alleged numerous causes of action under state law.[12] Hernandez filed for Chapter 7 bankruptcy in January 2015.[13] In January 2016, Lopez and the defendants agreed to remove her suit to the bankruptcy court.[14]

Hernandez alleged that he did not owe anything as a borrower to Lopez because Lopez was Hernandez's partner, not his lender, as evidenced by their conversations and course of conduct, even though there was no written joint venture agreement between Lopez and Hernandez or any of Hernandez's entities. Despite Lopez never becoming a member of Global Q, the court found that Lopez, Hernandez, and AQP "unwittingly formed a partnership by going into business together."[15] In Texas, regardless of whether the parties intend to or not, "an association of two or more persons to carry on a business for profit as owners creates a partnership."[16]

The Texas Business Organizations Code (TBOC) contains a five-factor test to determine whether a partnership has been formed:

> (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.[17]

The bankruptcy court noted that Texas courts apply the test using the totality of the circumstances.[18] The court found that the circumstances of this arrangement satisfied four of the five factors: (1) Lopez and Hernandez intended to share profits, evidenced by Lopez continuing to fund Global Q with the belief that she would eventually profit from it; (2) Lo-

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9. *Id.* at 375. Hernandez was unable to provide the financial information, in part, because he had not paid his accounting firm and could not access the documents that the accounting firm held. *Id.*

10. *Id.* at 374.

11. *Id.* at 375.

12. *Id.* Lopez filed suit on May 6, 2014. Lopez alleged, among other things, "breach of contract, common law fraud, fraud by nondisclosure, statutory fraud, negligent misrepresentation, theft under the Theft Liability Act, violation of the Texas Securities Act, promissory estoppel as a claim, unjust enrichment, quantum merit, money had and received, conversion, vicarious liability by piercing the corporate veil, conspiracy, declaratory judgment action, and accounting." *Id.*

13. *Id.*

14. *Id.*

15. *Id.* at 377.

16. *Id.* at 377–78 (quoting Tex. Bus. Orgs. Code Ann. § 152.051).

17. *Id.* at 378 (citing Tex. Bus. Orgs. Code Ann. §152.052(a)).

18. *Id.* (citing Ingram v. Deere, 288 S.W.3d 886, 891 (Tex. 2009)).

pez intended to become a partner in the business by signing the Subscription Agreement and by referring to the arrangement as "our partnership"; (3) Lopez participated in the control of the business by attending meetings with Hernandez and AQP to discuss and make business decisions; and (4) Lopez agreed to contribute money to the partnership by making seven deposits to the partnership totaling over $671,270.00.[19]

In re Hernandez is a compelling example of why entities and individuals need to be circumspect in using the terms "partners" and "partnership" with respect to any business relationship—no matter how casually such terms are intended. In this case, the use of these terms by Lopez was her death knell when determining the issue of whether a partnership had been formed. The bankruptcy court relied heavily on the use of the word "partners," attending meetings, and depositing money created a "de facto" partnership. Ultimately, when the business venture failed, Lopez suffered the consequences of implying a partnership had been formed.[20]

B. Creation of Partnership by Oral Agreement

Using the five-factor test outlined in Section 152.052 of the TBOC, in *Thunder Rose Enterprises, Inc. v. Kirk*, the Corpus Christi Court of Appeals upheld a jury's finding that a partnership existed by oral agreement, despite the parties never entering into a written agreement.[21]

In 2007, Michael Palmer (Palmer) patented a unique valve that he invented to be used in the oil and gas industry; Palmer assigned the patent rights to the valve to Thunder Rose Enterprises, Inc. (Thunder Rose), a company co-owned by his daughters.[22] Thunder Rose, in preparation for marketing of the valve, applied for trademarks for "Bullhead," "Bullhead Control Systems," and "Box Carrier."[23] In 2008, Palmer and Billy Kirk (Kirk) met to discuss financing the testing and marketing of the valve.[24] In 2009, Palmer, Kirk, and Kirk's associate Dickie McGee (McGee) (with whom Kirk owned Thrubore Valves LLC (Thrubore)) met with Paul Wang (Wang), who operated Centermart, a Chinese manufacturer.[25] At that meeting, (1) Wang, Kirk, and McGee executed a non-disclosure agreement, which stated in part that nothing contained within such agreement created a partnership; and (2) Kirk and Palmer agreed that Centermart would build a steel prototype of the valve at Thurbore's expense.[26] A month later, Kirk created a bank account for "Excalibur" that

19. *Id.*
20. The consequences of forming a partnership cost Lopez a great deal of money ($600,000.00, her partnership contribution) which was considered a dischargeable debt in bankruptcy. See Section III *infra* for a discussion of the duties Hernandez owed to Lopez as partners.
21. Thunder Rose Enters., Inc. v. Kirk, No. 13-15-00431-CV, 2017 WL 2172468 (Tex. App.—Corpus Christi Apr. 20, 2017, pet. denied).
22. *Id.* at *1.
23. *Id.*
24. *Id.*
25. *Id.*
26. *Id.*

included each of Kirk, Palmer, and McGee as authorized signatories.[27] Kirk used the account to pay Palmer's attorney for patent work, among other expenses for the prototype's development.[28]

That same year, McGee and Kirk prepared a draft agreement for Excalibur, which was never executed, that stated "the parties did not intend to form a partnership or joint venture."[29] The draft agreement contemplated that Palmer would assign the patent rights and both McGee and Kirk would contribute $100,000 to Excalibur.[30] Thunder Rose and Palmer proposed that Excalibur was to be jointly owned by Thrubore and Thunder Rose, with Thrubore contributing $5 million to Excalibur.[31]

In February 2010, the valve was delivered to Kirk and, even though it tested well in a machine shop, Palmer objected to certain changes to the design, claiming that such changes made the valve less safe.[32] In May, Kirk ordered another prototype from Douson, a different Chinese manufacturer.[33] A few months later, Palmer traveled to China to take part in the prototype's testing and began modifying the design for safety and operational reasons.[34]

In September 2010 and June 2011, Kirk instructed his attorney to draft the fundamentals of a license agreement to be entered into by Thunder Rose and Kirk and a draft limited liability company agreement for Bullhead Control Systems, LLC.[35] The parties dispute that either of these documents contain negotiated provisions; neither were executed.[36] In September 2011, Kirk received from Palmer's attorney a cease and desist letter insisting that Kirk end all activity in connection with the valve and "Bullhead."[37] Kirk filed suit that same month, alleging that he and Palmer formed a partnership and that Palmer breached his duty of loyalty to Kirk.[38]

At trial, the jury found that Kirk and Palmer orally entered into a partnership and that such oral partnership agreement contained the following terms: (1) Kirk would supply the capital to develop and produce the valve; (2) profits and losses were to be split evenly between Kirk and Palmer; and (3) Kirk was to receive an exclusive license to market and sell the valve.[39] The trial court, based on the jury's findings, ordered the

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27. *Id.*
28. *Id.*
29. *Id.*
30. *Id.*
31. *Id.* at *2. Clearly, the parties were on different pages regarding the economics of the arrangement. However, Kirk and McGee did apply for a $2 million loan from Wells Fargo, which was denied. *Id.*
32. *Id.*
33. *Id.*
34. *Id.*
35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.* at *3.
39. *Id.*

parties to perform under the partnership agreement.[40]

The appellants, Thunder Rose and Palmer, contended that: (1) there was not sufficient evidence to support the jury's finding of a partnership; and (2) the statute of frauds prevents the formation of the alleged partnership.[41]

The court of appeals stated that the determination of whether a partnership has been formed is governed by the TBOC, specifically the five-factor formation test considered in the totality of the circumstances.[42] In making its determination, the court relied on Kirk's testimony during trial, in which he stated that he and Palmer had "agreed on the agreement, shook hands" that they would split profits and losses evenly, with Kirk providing funding and overseeing manufacturing of the valve, while Palmer would give Kirk the exclusive rights to the valve and serve as technician.[43] Further, Kirk's attorney's testified that Palmer and Kirk "held each other out as partners" and "had equal control of the business."[44] The court of appeals ultimately found this testimony, along with emails showing the same and the expenditure of funds by both parties to develop the valve, as evidence that Palmer and Kirk: (1) both intended to share profits and losses[45]; (2) participate in controlling the business[46]; and (3) contribute money and property to the business.[47] By satisfying these factors, the court of appeals found sufficient evidence of partnership formation.[48]

Additionally, that Palmer expressly held Kirk out as his partner in emails to third parties (which reiterates the danger of casually using "partner" and "partnership" terminology) justified the finding of partnership formation.[49] While simply calling a person "partner" is not alone sufficient to establish a partnership, taken into consideration with the actions of the parties, certainly signals the intent of the parties.[50] Further, the court of appeals noted that even though the parties did not execute a formal agreement, that is not conclusive evidence that they did not orally

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40. *Id.* at *4.

41. *Id.*

42. *Id.* at *5 (citing TEX. BUS. ORGS. CODE ANN. § 152.052(a)); *see also supra* Section II.A.

43. *Thunder Rose Enters., Inc.*, 2017 WL 2172468, at *5.

44. *Id.* at *6.

45. *Id.* Sharing in profits satisfies the first factor of the five-factor test; intent to be in business together is the second factor; sharing in the losses of the business satisfies factor four. *Id.*; *see also* TEX. BUS. ORGS. CODE ANN. § 152.052(a) (West 2006).

46. This finding satisfies the third factor. *Thunder Rose Enters., Inc.*, 2017 WL 2172468, at *5; *see also* TEX. BUS. ORGS. CODE ANN. § 152.052(a) (West 2006).

47. *Thunder Rose Enters., Inc.*, 2017 WL 2172468, at *6. Kirk contributed over $400,000.00 to developing the valve. Palmer had expended his own funds throughout the development process. *Id.*

48. *Id.* at *7.

49. *Id.* at *6. Likely damning, Palmer referred to himself as Kirk's "favorite partner" in an email. *Id.*

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

agree to partner up.[51]

The appellants' second argument was that formation of a partnership by oral agreement is precluded by the statute of frauds.[52] The statute of frauds requires certain agreements to be written and signed to be enforceable.[53] The appellants' statute of frauds argument focused on the time to perform the contract, relying on the statute's prohibition of "oral contracts that cannot be completed within one year."[54] The court of appeals noted, however, that "a contract that could *possibly* be performed within a year, however improbable performance within one year may be, does not fall within the statute of frauds."[55] Appellants pointed to the length of a patent term, twenty years from the date of application filing, as evidence that the agreement to develop and sell the valve could not be completed within one year.[56] The court of appeals rejected this assertion, finding nothing in the record to indicate that the parties intended for the license to last for the entire patent term, and instead pointing to feasibility of completion of each element of the agreement (assigning the patent, granting the license, and funding) within one year.[57]

This case emphasizes the need for partners to clearly outline the relationship between the participants. Texas juries have found that a partnership has been formed on numerous occasions based on an oral agreement that takes into account the expectations, conversations, and emails of the participants. Such jury findings are difficult to overcome on appeal, so business participants should commit to formal agreements that memorialize the intent and obligations of the parties.

51. *Id.* at *7. The appellants argued that the draft agreement and the NDA stated that no partnership was being formed. The court stated, "to the extent this evidence supports a finding that no partnership was intended, the jury was entitled to reject it." *Id.*

52. *Id.*

53. *Id.* Appellants also asserted that three statutory provisions precluded the formation of a partnership. *Id.* at *8. First, appellants argued that, in order to be effective, trademark and patent assignments must be in writing. *Id.* (citing 15 U.S.C.A. § 1060(a)(3)). The court of appeals rejected this argument as inapplicable, since the issue was whether the partnership was formed, not whether the intellectual property rights had been assigned. *Id.* The court acknowledged that the agreement contemplated Palmer's conveyance of a license to the partnership but noted that "patent licenses are not subject to the statute of frauds." *Id.* Second, appellants argued that Section 101.151 of the TBOC provides that a promise to contribute property to a company is only enforceable if in writing and executed by the promisor. *Id.* (citing Tex. Bus. Orgs. Code Ann. § 101.151). Again, the court of appeals rejected this statute as inapplicable because, under the oral partnership agreement, neither party promised to contribute property to the company—Palmer was obligated to convey a license, not the intellectual property itself to the company. *Id.*

54. *Id.* (citing Niday v. Niday, 643 S.W.2d 919, 920 (Tex. 1982)).

55. *Id.* (citing Beverick v. Koch Power, Inc., 186 S.W.3d 145, 149 (Tex. App.—Houston [1st Dist.] 2005, pet. denied)).

56. *Id.*; *see also* 35 U.S.C.A. § 154(a)(2) (2015).

57. *Thunder Rose Enters., Inc.*, 2017 WL 2172468, at *7.

III. DUTIES OWED BY PARTNER

A. Plaintiff's Due Diligence Requirements

In *Tho Q. Pham v. Carrier*, the Amarillo Court of Appeals declined to impose fiduciary duties on two limited liability company members who caused the company to transfer an asset of the company to another entity without the knowledge of the other member.[58] In 2002, Tho Q. Pham (Pham), Jason Bryan Carrier (Carrier), and Stephen Bradley Womack (Womack) were members of Austin Barfish, LLC (Barfish).[59] Barfish owned a bar on Sixth Street in Austin, Texas.[60] Carrier and Womack collectively owned 60% of the interests in Barfish, and Pham owned the remaining 40% of Barfish.[61] In both 2002 and 2003, Pham received distributions from Barfish, but in 2004, Pham moved away from Austin and did not communicate with either Carrier or Womack until 2011.[62] Prior to leaving Austin, Pham asked Carrier and Womack not to transfer or otherwise distribute Pham's share of the profits in Barfish.[63] Pham brought suit in 2013 after he discovered that Carrier and Womack had caused Barfish to transfer ownership in the bar to another limited liability company, which was formed and owned by Carrier and Womack to the exclusion of Pham.[64]

After noting that a party to a contract is not, in general, bound by a fiduciary duty to the other parties to the same contract, the court of appeals found that, in the context of such a contractual relationship, each party must exercise due diligence in maintaining its relationship with the other parties to protect its interests.[65] A party will only recover damages for inherently undiscoverable injuries or in connection with breaches that were not discoverable through the exercise of reasonable due diligence.[66] Here, because Pham failed to demonstrate that he had adequately acted upon this due diligence requirement regarding Barfish, and his relationship with Carrier and Womack, Pham was unable to persuade the court of appeals that the type of injury Pham suffered at the hands of Carrier and Womack was inherently undiscoverable.[67]

From all appearances, the court of appeals seemingly presumed that Pham admitted that Carrier and Womack did not owe Pham fiduciary duties individually since Pham acknowledged the trial court's prior ruling

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58. Tho Q. Pham v. Carrier, No. 07-15-00031-CV, 2017 WL 1291660, at *1 (Tex. App.—Amarillo Apr. 3, 2017, no pet.).
59. *Id.*
60. *Id.*
61. *Id.*
62. *Id.*
63. *Id.*
64. *Id.*
65. *Id.* at *5.
66. *Id.* (quoting HECI Expl. Co. v. Neel, 982 S.W.2d 881, 886–87 (Tex. 1998)).
67. *Id.* This finding was in spite of the fact that there was limited public evidence of the sale of Barfish and that Pham had not been involved in the day-to-day operation and management of the bar.

on this matter.[68] Quite interestingly, and despite the fact that an appeals court reviews a summary judgment *de novo*,[69] the court of appeals did not directly address the trial court's finding of an absence of fiduciary duties nor the meaning of Pham's simple acknowledgment that the trial court had ruled on this matter.[70] This is noteworthy because the existence or the nonexistence of a fiduciary duty would likely have impacted the outcome of this case. Moreover, the court of appeals did not look to the terms of the agreement governing Barfish, which is in contrast to the emphasis typically placed on the terms of partnership governing documents in other Texas partnership law cases involving fiduciary duties.

B. Breach of Duty in Bankruptcy: Non-Dischargeable Debts

In *In re Hernandez*, discussed above, the bankruptcy court found that Lopez and Hernandez had formed a de facto partnership.[71] The court also illustrated the instances in which a partner of a de facto partnership owed a duty of full disclosure to the other parties, and that the debt stemming from a breach of such duty is nondischargeable in a bankruptcy proceeding.[72] The question of whether a breach of fiduciary duty is dischargeable in bankruptcy is a question of federal law; however, state law determines whether a duty exists.[73] In the partnership context, Texas courts have found that partners owe each other a duty of candor and full disclosure.[74]

The TBOC outlines that the partners owe the other partners in the partnership a duty of loyalty and care; the partner must carry out those duties in good faith.[75] The duty of loyalty includes the "duty to account to the partnership for property and profits."[76] Partners also owe each other a duty of *full disclosure* concerning partnership interests.[77] In this case, Hernandez had a duty to provide financial documents to Lopez upon request.[78] A breach of this fiduciary relationship triggers liability for such breach under 11 U.S.C. §523(a)(4).[79]

In a bankruptcy proceeding, a debt incurred "for fraud or defalcation

68. *Id.* at *4 n.6.
69. *Id.* at *2.
70. *Id.* at *4 n.6. The court of appeals appears to equate Pham's acknowledgement of the trial court's dismissal of Pham's breach of fiduciary duty claim with an admittance by Pham of the fact (or legal principle) that Carrier and Womack did not owe Pham a fiduciary duty in connection with Barfish.
71. *See supra* Section II.
72. *In re* Hernandez, 565 B.R. 367, 378–79 (Bankr. W.D. Tex. 2017).
73. *Id.* at 379 (citing Gupta v. E. Idaho Tumor Inst., Inc. (*In re* Gupta), 394 F.3d 347, 349–50 (5th Cir. 2004)).
74. *Id.* (citing Hawthorne v. Guenther, 917 S.W.2d 924, 934 (Tex. App.—Beaumont 1996, writ denied)).
75. *Id.* at 379 (citing Tex. Bus. Orgs. Code Ann. § 152.204 (West 2015)).
76. *Id.* (citing Tex. Bus. Orgs. Code Ann. § 152.205).
77. *Id.* (citing *Hawthorne*, 917 S.W.2d at 934).
78. *Id.*
79. *Id.* at 378 (citing Schwager v. Fallas (*In re* Schwager), 121 F.3d 177, 186 (5th Cir. 1997)).

while acting in a fiduciary capacity" is a non-dischargeable debt.[80] Defalcation is a willful breach of fiduciary duty.[81] Willfulness is a measurement of recklessness, evaluated by "what a reasonable person in the debtor's position knew or reasonably should have known."[82] The bankruptcy court found that under Texas law, Hernandez owed a duty of full disclosure to Lopez, and his breach of that duty amounted to "defalcation while acting in a fiduciary capacity" when he did not provide the requested financial information in a reasonable period of time.[83] As a result, the money Lopez loaned or contributed to the partnership after Lopez's second request for financial information that was not satisfied by Hernandez is a non-dischargeable debt.[84]

IV. PERSONAL LIABILITY OF A MANAGING MEMBER

In *Chico Auto Parts & Service, Inc., v. Crockett*, the El Paso Court of Appeals opined on the personal liability of a member of a limited liability company.[85] Chico Auto Parts & Service, Inc. (Chico) appealed an order granting summary judgment to the defendants, Black Strata, a limited liability company, and Craig Crockett (Crockett).[86] Chico provides remediation services for hazardous materials.[87] Crockett was the managing member of Black Strata, and operated an oil well in Tarrant County (the Well), upon which Chico performed remediation services.[88] At the time the services were provided, Crockett was also the president and CEO of Montcrest Energy Inc. (Montcrest) and a part-owner in the oil and gas interests of the Well.[89] Montcrest was also a part-owner of the Well's oil and gas interests.[90]

The parties disputed with whom Chico contracted for its services.[91] Chico sent an invoice for $63,415.55 to Montcrest; a few months later, Black Strata sent Chico two checks for $10,000.00 each.[92] Chico did not receive any further payment on the invoice and sued Montcrest for the balance under breach of contract and quantum meruit theories.[93] The trial court entered an agreed judgment for $43,415.55 plus attorneys'

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80. 11 U.S.C. § 523(a)(4) (2018).
81. *In re Hernandez*, 565 B.R. at 379 (quoting *In re* Harwood, 637 F.3d 615 624 (5th Cir. 2011)).
82. *Id.*
83. *Id.*
84. *Id.*
85. Chico Auto Parts & Serv., Inc. v. Crockett, 512 S.W.3d 560, 565 (Tex. App.—El Paso 2017, pet. denied).
86. *Id.* at 565–66. The owner of the land on which the well sits was also a defendant in this case. *Id.*
87. *Id.* at 566.
88. *Id.*
89. *Id.*
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*

fees.[94] However, Montcrest filed for bankruptcy soon thereafter, without making any payments under the judgment.[95]

Chico appealed to place liability on Crockett as managing member of Black Strata.[96] The court explained that the fundamental principle of corporate law—that a "corporation is a separate legal entity from its shareholders, officers, and directors"—applied to this case.[97] However, in the event a "corporate affiliate"[98] uses a corporate form as an "unfair device to achieve an inequitable result," courts have found it just to ignore the corporate structure and apply the common law principle known as "veil-piercing."[99] In Texas, the most frequently used basis for piercing the corporate veil is the "alter ego theory," which requires a plaintiff to prove that the officer of the corporation used the entity for personal purposes disregarding corporate formalities.[100] In July 2011, when Chico performed its services, there were two statutes in effect that limited the instances in which a managing member could be personally liable.[101] The court of appeals pointed to the long line of Texas courts that did not view such statutes as a complete block to personal liability of limited liability company members, finding that the common law principles for piercing the veil that applied to corporations also applied to limited liability companies.[102]

The court of appeals noted that in pursuit of piercing the corporate veil, the plaintiff has the burden of proof, including the burden to affirmatively plead all elements of a claim or the failure to do so results in the waiver of such claims.[103] Here, Chico simply failed to assert any allega-

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94. *Id.*

95. *Id.*

96. *Id.* at 567, 570. Chico essentially brought the same case it brought against Montcrest against a new slate of defendants including Black Strata, Crocket, and the fee simple and a royalty interest owner of the land. The court noted that if there were a contract, it "was with Black Strata, and that if Crockett negotiated the contract, it was in his individual capacity as the managing member of Black Strata, rather than in his capacity as a Well owner." *Id.*

97. *Id.* at 570 (citing TransPecos Banks v. Strobach, 487 S.W.3d 722, 728 (Tex. App.—El Paso 2016, no pet.)).

98. *Id.* at 570–71. A "corporate affiliate" is a collective reference to a corporation's shareholders, owners, directors, or other affiliates. *Id.* (citing Castleberry v. Branscum, 721 S.W.2d 270, 271 (Tex. 1986)).

99. *Id.*

100. *Id.* at 571 (citing *TransPecos*, 487 S.W.3d at 728–29).

101. *Id.* (referencing TEX. BUS. ORGS. CODE ANN. § 101.114 (West 2012) (which provides "a member or manager is not liable for a debt, obligation, or liability of a limited liability company" unless the company agreement specifically provides otherwise); TEX. BUS. ORGS. CODE ANN. § 101.113 (West 2012) (which provides "a member of a limited liability company may be named as a party in an action by or against the limited liability company only if the action is brought to enforce the member's right against or liability to the company")). Effective September 1, 2011, the Texas legislature eliminated the alter ego theory by adopting § 21.223 of the TBOC, which provides that only if actual fraud is committed for the corporate affiliate's personal benefit, then the court may pierce the corporate veil and impose personal liability on a member of a limited liability company. TEX. BUS. ORGS. CODE ANN. § 21.223(a)(3).

102. *Chico Auto Parts & Serv.*, 512 S.W.3d at 571.

103. *Id.*

tions in its pleadings that it intended to pursue Crockett for individual liability under an alter-ego theory.[104] Because Chico failed to affirmatively assert any argument or evidence that Crockett should be held liable as an individual, the court of appeals found that Chico had waived this claim.[105]

Although in this case the pleadings were insufficient for the court of appeals to pierce the corporate veil, this case underscores the importance of clarifying with whom a contract is with, particularly when dealing with individuals that may be acting as agents of a limited liability company or partnership. It is equally important for agents acting on behalf of limited liability companies and partnerships to document the transaction and to be consistent and clear regarding the capacity in which they are acting in interactions with third parties to avoid personal liability.

V. DERIVATIVE CLAIMS

Guerrero-McDonald v. Nassour, from the Eastland Court of Appeals, reviews and expounds upon Texas case law regarding the ability of a limited partner to bring derivative claims against a partnership.[106] In its opinion, the court of appeals traced the development of Texas case law on derivative claims from the corporate context to the partnership context.[107] After this survey, the court of appeals denied several of Mary Guerrero-McDonald's (GMD) requested claims for derivative relief, while upholding several of GMD's other derivative claims as valid since GMD was "personally aggrieved"[108] by those claims.

Texas case law provides that a limited partner has standing to sue if such limited partner is personally affected by the allegedly wrongful action[109] and such alleged wrongful action does more than diminish the value of the partnership.[110] In particular, a mere diminishment of a limited partner's interest is not a cognizable injury that gives rise to a right by the limited partner to sue.[111] Derivative claimants must focus prima-

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104. *Id.*

105. *Id.*

106. Guerrero-McDonald v. Nassour, 516 S.W.3d 198, 202 (Tex. App.—Eastland 2017, no pet.). GMD's claim arises out of an ultimately unsuccessful real estate development project. This real estate project was for the development of a condominium in downtown Austin, Texas. After an initial investor died, GMD sought additional investors for the project. These investors formed La Vista Partners LP (La Vista). GMD converted her prior interests in the project into a 35% interest in La Vista. La Vista eventually faltered and, after being unable to secure construction financing to complete the project, failed. GMD sued the other partners and the general partner of La Vista (the Appellees) for breach of contract, breach of fiduciary duty, fraud, and negligent misrepresentation. The trial court dismissed all GMD's claims, except for her fraud claim. The jury returned a verdict on GMD's fraud claim in favor of the Appellees. GMD appealed the trial court's judgment on her five claims. *See generally id.* at 202–03.

107. *Id.* at 203–06.

108. *Id.* at 205 (quoting *In re* Fisher, 433 S.W.3d 523, 527 (Tex. 2014)).

109. *Id.* at 204 (quoting Hall v. Douglas, 380 S.W.3d 860, 872 (Tex. App.—Dallas 2012, no pet.)).

110. *Id.* at 205 (quoting *Hall*, 380 S.W.3d at 873).

111. *Id.*

rily on the nature of the alleged injury,[112] which turns on whether the alleged injuries are suffered by the partnership generally or by the limited partner directly.[113] If the injury was personal to the partner, then such partner typically will have standing to sue.[114]

Using this framework, the court of appeals analyzed whether GMD's alleged injuries impacted her as an individual or whether those injuries were sustained by the limited partnership generally.[115] Among the alleged injuries, the court of appeals declined to find that the misuse or mismanagement of funds of the limited partnership were derivative claims because those claims impacted the valuation of the limited partnership as an entity rather than impacting GMD in her individual capacity.[116]

The court of appeals similarly denied GMD standing to assert a derivative claim for the partnership's failure to call additional capital contributions and to invest adequate capital in the operating assets of the partnership.[117] GMD argued that these actions uniquely, and negatively, impacted the value of her investment in the partnership since her partnership interest was the only interest protected from dilution in the event the partnership called additional capital contributions to fund the project.[118] The court of appeals rejected this claim, reasoning that although GMD's contribution to the operations of the partnership was unique and her limited partnership interest was protected from dilution, the other limited partners also lost their investment in the partnership on account of inadequate funding.[119] Thus, GMD was not entitled to bring a derivative claim because the alleged harm was not exclusive to her.[120]

In contrast, GMD successfully asserted standing in her claim that the partnership agreement was breached by the failure of the partnership to pay her pursuant to her consulting agreement with the partnership.[121] The court of appeals found that GMD's consulting agreement claim was unique to GMD since no other limited partner had a similar contractual arrangement with the partnership.[122] In overruling the trial court on this

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112. *Id.* (quoting *Hall*, 380 S.W.3d at 874).
113. *Id.*
114. *Id.* (quoting *In re* Fisher, 433 S.W.3d 523, 527 (Tex. 2014)).
115. *Id.* at 207.
116. *Id.* at 208 (citing Hodges v. Rajpal, 459 S.W.3d 237, 249 (Tex. App.—Dallas 2015, no pet.)).
117. *Id.*
118. *Id.* at 207.
119. *Id.*
120. *Id.*
121. *Id.* at 209. Interestingly, the Eastland Court of Appeals did not thoroughly evaluate the nature of GMD's standing and what impact, if any, the nature of this standing would have upon GMD's ability to bring her claim. The basis of GMD's claim is apparently anchored in a privity of contract theory between GMD and Guerrero-McDonald & Associates, Inc. The Eastland Court of Appeals dismisses the necessity of a privity of contract inquiry in its standing analysis by summarily noting that "whether a party is entitled to sue on a contract is not truly a standing issue because it does not affect the jurisdiction of the court." *See id.* at 208 n.4.
122. *Id.* at 208.

issue, the court of appeals found that this claim "diminished the value of GMD's interest in the limited partnership exclusively, rather than the value of the limited partnership generally."[123]

This case shows it is essential to properly plead a client's derivative claims for relief so as to highlight the direct and exclusive nature of the injury caused to the client-plaintiff by such a claim.[124] If a claim is not positioned in such a fashion, then a Texas court will likely reject the derivative claim on the grounds that the claimant lacks standing. As with other areas of the law, a proper framing of a derivative claim within the broader legal and factual setting out of which such claim emerges is essential to opening the courtroom doors to a claimant.

VI. CREDITOR'S REMEDIES AGAINST A MEMBER

A. Turnover Order: Text over Policy

The First Houston Court of Appeals analyzed the Texas charging order statute in *Pajooh v. Royal West Investments LLC, Series E* and determined that, pursuant to the text of the statute, a charging order is the exclusive remedy for a judgment creditor to enforce its claim against a judgment debtor's interests in a partnership.[125] Danesh Pajooh (Pajooh), a real estate developer and investor, was a 99% limited partner in County Investment L.P. (County Investment) and held 99% of the interests of County Investment's general partner, U.S. Capital Investments LLC (U.S. Capital Investments)[126] Pajooh, U.S. Capital Investments, and Royal West Investments LLC, Series E (Royal West) entered into a series of real estate transactions, which eventually soured. Litigation arose among the parties and resulted in a judgment of $352,380 plus approximately $165,000 in attorneys' fees in favor of Royal West.[127] Royal West was largely unsuccessful for two years in collecting on this judgment from Pajooh and U.S. Capital Investments.[128] After this initial period, Royal West discovered that, although Pajooh directly owned few material assets that could be used to satisfy the judgment, County Investment owned property worth approximately four million dollars, which included commercial real estate, a luxury car, antique automobiles, antique rugs, oil paintings, furniture, and other investments.[129]

Royal West then obtained a charging order against Pajooh's membership interest in U.S. Capital Investments, which prohibited U.S. Capital

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123. *Id.* at 209.
124. *Id.* at 205 (quoting Hall v. Douglas, 380 S.W.3d 860, 874 (Tex. App.—Dallas 2005, no pet.)).
125. Pajooh v. Royal West Inv. LLC, Series E, 518 S.W.3d 557, 562 (Tex. App.—Houston [1st Dist.] 2017, no pet.).
126. *Id.* at 559. Pajooh's sister, Jila Mesgarpouran, owned the remaining 1% interest in U.S. Capital Investments.
127. *Id.* at 560.
128. *Id.*
129. *Id.*

Investments from making any distributions to Pajooh.[130] The trial court also issued a charging order encumbering Pajooh's and U.S. Capital Investments' interests in County Investments.[131] The trial court later entered an additional order that required turnover of assets in satisfaction of the judgment debt and placed both Pajooh and U.S. Capital Investments, the two judgment debtors, under receivership.[132] This order gave the receiver broad power regarding the judgments debtors' assets, but did not specifically provide the receiver with any power over the judgment debtors' interests in County Investments or Pajooh's membership interest in U.S. Capital Investments.[133] This order also noted that a charging order is the exclusive means by which a judgment creditor may satisfy its claim against a judgment debtor's interests in a partnership.[134]

Pajooh and U.S. Capital Investments then moved to vacate this turnover and receivership order on the grounds that turnover order against their membership interests was in conflict with the exclusivity of charging orders under the TBOC.[135] Pajooh and U.S. Capital Investments also contended that the trial court's order was improper since there was no evidence that Pajooh and U.S. Capital Investments owned property that could not be attached through ordinary legal process.[136] During this period, Royal West suspected that Pajooh continued receiving distributions from County Investment in violation of the trial court's charging order.[137] Royal West acted on this suspicion and petitioned the trial court for a modification of the turnover and receivership order.[138]

The trial court granted Royal West's request and issued an amended order that appointed a receiver over the assets of Pajooh and U.S. Capital Investments, including their interest in County Investment L.P.[139] This amended order also specifically provided for the receiver to take possession of all the property and assets of Pajooh and U.S. Capital Investments, including their bank accounts.[140] Pajooh and U.S. Capital Investments appealed arguing that the trial court was in error because a charging order was the exclusive remedy pursuant to the TBOC.[141]

The court of appeals first addressed whether the trial court abused its discretion in the appointment of a receiver since a charging order is the exclusive remedy under the TBOC.[142] The court of appeals noted that the

130. *Id.*
131. *Id.*
132. *Id.*
133. *Id.*
134. *Id.*
135. *Id.*; *see* Tex. Bus. Orgs. Code § 153.256 (West 2012). Pajooh similarly argued that his membership interest in U.S. Capital Investments should not be subject to a turnover and receivership order. *Pajooh*, 518 S.W.3d at 560.
136. *Id.* at 561.
137. *Id.*
138. *Id.*
139. *Id.*
140. *Id.*
141. *Id.* at 562.
142. *Id.*

policy rationale for the charging order as an exclusive remedy was to limit disruption to the partnership's business by a judgment debtor liquidating a partnership interest in satisfaction of a nonpartnership debt.[143] Since a judgment creditor may not reach the property of the limited partnership,[144] a charging order enables the judgment creditor to attach to any distributions from the partnership that would otherwise go to the judgment debtor.[145] A charging order does not, however, permit a judgment creditor from participating in, or otherwise directly interfering with, the management and operation of the partnership.[146]

Royal West, in seeking to rebut the plain text of the charging order statute, marshaled several policy arguments in support of its position. Royal West argued that the exclusivity provisions of the TBOC did not apply because the policy justification for a charging order did not match the facts of this case.[147] Citing a Florida case and a federal bankruptcy case, Royal West contended that a charging order is intended to protect non-debtor partners and to prevent a judgment creditor from participating in the ownership and control of the partnership.[148] Royal West argued that the protective nature of the exclusivity of a charging order was absent in this case since there were no third-party interests to protect.[149] After noting the limited precedential value of cases from jurisdictions other than Texas, the court of appeals distinguished those cases from the case before the court on the ground that the holdings of those cases derive from statutory law unlike the Texas charging order statute[150] and pursuant to this finding, ultimately rejected Royal West's rationale for deviating from the statute.[151]

Royal West, citing that the text of the charging order statute referenced a "judgment creditor *of a partner*"[152] and not a judgment creditor of *all*

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143. *Id.* (citing Stanley v. Reef Sec., Inc., 314 S.W.3d 659, 664 (Tex. App.—Dallas 2010, no pet.)).

144. *Id.* at 563 (quoting Tex. Bus. Orgs. Code § 153.256(f) (West 2012)).

145. *Id.* at 562–63 (quoting *Stanley*, 314 S.W.3d at 664).

146. *Id.* at 563 (quoting *Stanley*, 314 S.W.3d at 664–65).

147. *Id.* (citing Tex. Bus. Orgs. Code § 153.256(d) (West 2012)).

148. *Id.*

149. *Id.*

150. *Id.* In the bankruptcy proceeding, the bankruptcy court held, "as a matter of Colorado law, that the debtor's Chapter 7 bankruptcy filing assigned her membership interest in the LLC to the bankruptcy estate, transferring to the trustee the right to manage it—including the right to liquidate the LLC's assets." *Id.* at 563 n.1 (quoting *In re* Albright, 291 B.R. 538, 540–41 (Bankr. D. Colo. 2003)). The court of appeals stated that the *Albright* decision "rested on Colorado law that recognized the trustee as the 'substituted member' of the LLC, with all the rights of the member who assigned her membership interest to the bankruptcy estate." *Id.* at 563 n.1 (citing *Albright*, 291 B.R. at 540 & n.5). Rounding out this argument, the court of appeals went on to find that "there is no analogous Texas statute that justifies a transfer of control over the limited partnership [interest]." *Id.* Similarly, "and in contrast to the Texas statute at issue in this appeal, the Florida statute plainly provided that a charging order was a nonexclusive remedy as to an LLC." *Id.* (citing Olmstead v. Fed. Trade Comm., 44 So.3d 76, 81–82 (Fla. 2010)).

151. *Id.*

152. *Id.* at 564 (quoting Tex. Bus. Orgs. Code § 153.256(d) (West 2012)) (emphasis added). Royal West's argument apparently turns on the notion that Pajooh was not merely

the partners, also contended that a reference to a "partner" in the TBOC applied to one or more partners, but fewer than all of the partners, and not to a circumstance in which all of the partners are jointly liable.[153] The court of appeals rejected this argument, noting that Texas courts should only utilize the tools of statutory construction when the statute's language is unclear or ambiguous.[154] Since the court of appeals did not agree that the specific charging order provisions of the TBOC under consideration were unclear, it did not believe there was a need to resort to extrinsic aids to clarify the meaning of the statute.[155] As a result, the court of appeals declined to impose an exception to the Texas charging order statute pursuant to Royal West's textual arguments and concluded that a judgment creditor's exclusive remedy against a judgment debtor's partnership interest is a charging order.[156]

The court of appeals did, however, suggest that ordering a judgment debtor to turnover its distribution from a partnership could be proper pursuant to a turnover and receivership after such distribution has been made to the judgment debtor,[157] even if the turnover order did not specifically identify the property subject to the turnover order.[158] On this basis, the court of appeals held that the turnover and receivership order was a proper means to monitor distributions from the partnership and enforced Royal West's charging order against Pajooh and U.S. Capital Investments.[159] The court of appeals ultimately affirmed the trial court's imposition of receiverships on both Pajooh and U.S. Capital Investments,[160] but reversed the trial court's order to the extent the order imposed a receivership on the membership interests of Pajooh and County Investment.[161] This case draws a carefully delineated analytical distinction between a turnover and receivership order against a partnership interest and a turnover and receivership order against distributions received in connection with a partnership interest. In doing so, the court of appeals does not conflate the equitable remedies available to Texas courts with statutorily mandated exclusivity provisions.

B. Turnover Order: Policy over Text

In contrast to *Pajooh*, the Fourteenth Houston Court of Appeals, in *Gillet v. ZUPT, LLC*, declined to reverse a trial court's determination

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"a partner" but was in fact "all the partners", through his direct and indirect interests, in County Investment.

153. *Id.* Royal West's textual contention was that the same word in different parts of the same statute should be afforded the same meaning unless a different intent is otherwise clear.

154. *Id.* (citing Molinet v. Kimbrell, 356 S.W.3d 407, 414 (Tex. 2011)).

155. *Id.*

156. *Id.* at 565 (citing Tex. Bus. Orgs. Code § 153.256 (West 2012)).

157. *Id.* at 566–67.

158. *Id.* at 566 (quoting Tex. Civ. Prac. & Rem. Code § 31.002(h) (West 2008)).

159. *Id.* at 567.

160. *Id.* at 568.

161. *Id.*

that a turnover order could be levied against a member's interest in a limited liability company despite the Texas statute's explicit command that a charging order is the exclusive remedy for the satisfaction of a judgment creditor's claim against a membership interest of a judgment debtor.[162] In 2012, an arbitrator determined that ZUPT, LLC (ZUPT), a limited liability company, owed Joel Gillet (Gillet), one of its members, $499,050 pursuant to a buy-sell agreement that required ZUPT to purchase Gillet's membership interest in ZUPT.[163] The arbitrator further found that Gillett would transfer his entire ownership interest back to ZUPT upon payment of $499,050 to Gillett by ZUPT.[164] ZUPT then sought the trial court's confirmation of the arbitrator's awards, whereupon the trial court ordered a turnover of Gillet's membership interest in ZUPT.[165] Gillet appealed the trial court's turnover order against Gillet's interests in ZUPT.[166]

At the outset of its analysis, the court of appeals noted that a Texas appellate court is required to affirm a trial court's turnover order unless such order is unreasonable or arbitrary.[167] As a result, a Texas appeals court will not reverse a trial court's turnover order even if such order is based on an incorrect reading of law.[168] Gillet, as the appellant, argued that a charging order was the only remedy available to ZUPT to satisfy its claim against Gillet's interest in ZUPT and that the trial court erred in ordering a turnover of Gillet's interest.[169] Gillet also contended that, because a charging order is a lien on the interest of the debtor that may not be foreclosed, a judgment creditor is only entitled to the receipt of distribution.[170] The court of appeals, noting that this question appears to be one of first impression, quickly turned to policy arguments to overcome the statute.

The court of appeals outlined that the purpose of a charging order is to prevent a disruption of a partnership's business through a forced liquidation of a partnership interest in satisfaction of a judgment creditor's claim.[171] The policy reasons for exclusively issuing a charging order are inapplicable in this case, according to the court of appeals, because the judgment creditor is the entity in which the judgment debtor holds his interest.[172] In other words, the court of appeals tacitly alleges that the Texas legislature could not have intended to bar a turnover order when

162. Gillet v. ZUPT, LLC, 523 S.W.3d 749 (Tex. App.—Houston [14th Dist.] 2017, no pet.).
163. *Id.* at 752–53.
164. *Id.* at 753.
165. *Id.*
166. *Id.*
167. *Id.* (citing Beaumont Bank, N.A. v. Buller, 806 S.W.2d 223, 226 (Tex. 1991)).
168. *Id.* at 754 (quoting *Buller*, 806 S.W.2d at 226).
169. *Id.* at 757.
170. *Id.* (citing Tex. Bus. Orgs. Code § 101.112(c) (West 2012)).
171. *Id.* (citing Stanley v. Reef Sec., Inc., 314 S.W.3d 659, 664 (Tex. App.—Dallas 2010, no pet.)).
172. *Id.*

the judgment creditor is the entity seeking to enforce a turnover of an interest in the judgment creditor—this in spite of the text of the statute.

In holding that the trial court did not abuse its discretion by finding that a charging order was not ZUPT's exclusive remedy, the court of appeals scaffolded this outcome on the basis of two policy rationales. As noted above, the first rationale was that the legislative intent underlying the exclusivity of a charging order is not applicable when a judgment creditor is the entity seeking to enforce the turnover order.[173] Second, because the facts involved the transfer of the membership interest from Gillet to ZUPT,[174] the business affairs of ZUPT would not be disrupted as a result of the liquidation of the membership interest in ZUPT.[175] In this circumstance, the court of appeals concluded that a turnover order was proper.[176]

VII. CONCLUSION

The cases from this survey period underscore the critical importance of memorializing the intent of the parties in joint venture agreements. Parties' interactions and language with one another have proven to be highly relevant as to partnership classification issues and partnership matters, even when the relevant written agreements do not appear to be ambiguous. Drafters should also remain attuned to Texas courts' apparent willingness to entertain policy arguments when interpreting statutory law, and litigators are advised to follow procedural requirements thoroughly when prosecuting a Texas partnership law case or controversy on behalf of a client. As with other years, a counsel's responsibility to stay abreast of recent developments in Texas partnership law is crucial for the effective representation of a client in negotiating and enforcing partnership agreements.

173. *Id.* at 758.
174. *Id.*
175. *Id.* at 757.
176. *Id.* at 758.