SMU | Dedman School of Law

SMU Law Review

Volume 60 | Issue 3 Article 22

January 2007

# Partnerships

Steven A. Waters

Joel Iglesias

# PARTNERSHIPS

*Steven A. Waters**
*Joel Iglesias***

## I. INTRODUCTION

THE cases chosen for review in this Survey will not change the face of Texas jurisprudence. In fact, some of them are relatively insignificant; overall, however, they provide some educational tidbits that justify inclusion.

## II. PARTNERSHIP CASES

### A. FIDUCIARY DUTIES

#### *1. Deere v. Ingram*[1]

This case involved a claimed oral partnership (joint venture, actually[2]) and allegations of breach of contract, breach of fiduciary duty, and ultimate termination of a partnership at will triggered by the withdrawal of a partner.[3]

Ingram wanted to establish a pain-management clinic, but, as a psychologist, he needed a medical doctor to be the clinic's medical director. Dr. Deere fit that bill, so the parties made an oral arrangement to share revenues of the clinic. About fifteen months later, Ingram presented a written agreement to Deere, entitled "Physician's Contractual Employment Agreement," stipulating that Ingram was the sole owner of the pain clinic. Deere refused to acknowledge that he was only an employee, and so he left, apparently never to return.

Deere did not file suit until almost three years later, asking for $2,525,437.00 in damages (his share of revenues) for the period between

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* B.A., Southern Methodist University; J.D., University of Texas (with honors). Attorney at Law, Haynes and Boone, L.L.P., San Antonio, Texas.

** B.S., The University of Texas; M./B.A., University of Houston; J.D., University of Houston (magna cum laude). Attorney at Law, Haynes and Boone, L.L.P., Houston, Texas.

1. 198 S.W.3d 96 (Tex. App.—Dallas 2006, no pet.).

2. The common distinction is that a joint venture is a general partnership for a limited purpose, but Texas common law has grafted an additional requirement. *See, e.g.*, Steven A. Waters, *Partnerships*, 55 SMU L. REV. 1271, 1274–75 (2002); *see also*, TEX. REV. CIV. STAT. ANN. art. 6132b, § 2.02(a) (Vernon 2006) (including "joint venture" in definition of "partnership").

3. There also was some procedural fun including a jury verdict, entry of a Judgment Notwithstanding the Verdict ("JNOV") by the original trial judge, recusal by that original trial judge, and entry by the successor trial judge of a second JNOV, among other things. *Deere*, 198 S.W.3d at 99.

the time he left through trial and another $2,500,000.00 for his share of revenues after the trial. The jury found that the parties had an oral joint venture, that Ingram both owed and breached fiduciary duties to Deere, and that Ingram breached the oral joint venture agreement. Consequently, the jury awarded Deere damages and attorney's fees.[4]

The original trial judge, Evans, responded to Ingram's Motion for a JNOV by deleting the $2,500,000.00 post-trial award and reducing the attorney's fees. A second trial judge, Hartman, granted Ingram's second motion for a JNOV and ordered that Deere take nothing from Ingram.[5] Deere appealed.[6]

Ingram made two relevant assertions in his second motion for JNOV: (1) that the trial court improperly awarded $2,525,437.00 because future damages are not recoverable in a terminated partnership at will[7]; and (2) that the trial court incorrectly concluded that Ingram owed Deere fiduciary duties because a partnership did not create a fiduciary relationship.[8]

Although he apparently tried to force an after-the-fact employment relationship on Deere, Ingram did not argue that there was not an oral partnership. Instead, he argued that he and Deere had created a partnership at will[9] that terminated[10] in March 1999 when Deere refused to sign the employment agreement (stating that Ingram was the sole owner of the clinic).[11]

The first order of business was for the Dallas Court of Appeals to determine whether the Texas Revised Partnership Act[12] ("TRPA") applied. After considering the parties' arguments and citing recent case law supporting the TRPA's application to an oral partnership,[13] the court of ap-

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4. *Deere*, 198 S.W.3d at 99.

5. As the case makes clear, Hartman had the disadvantage of not having been the presiding judge at trial, nor was he provided a record from which to work. His original decision was to grant a new trial, but after Deere objected to that, he opted for the JNOV in favor of Ingram. *Id.* at 98–99.

6. *Id.* at 99–100.

7. The opinion included "oral" before "partnership," but that seems irrelevant to the issue. Also, recall that at this stage, Ingram already had one JNOV in his favor, that the $2,500,000 of post-trial damages were not allowed. *Id.*

8. *Id.* at 100. More on this later, but in modern jurisprudence and with the possible exception of trusts, partnerships have been the most fertile location of fiduciary duties.

9. A partnership at will relationship can be terminated by the affirmative action of either partner at any time, generally without consequences.

10. Over the years, terms that describe a partnership's change of status have caused much confusion. The former scheme was that "dissolution" was followed by "winding up" that was followed by "termination" of the partnership's existence. Now, the scheme in Texas is "withdrawal" of a partner that may or may not be "an event requiring a winding up" that leads to a "termination" of the existence of the partnership Lawyers, courts, and commentators frequently default to "termination," when that is not correct, or they use "dissolution" to mean the end of the partnership. Fortunately, the term "dissolution" was not included in the Texas Revised Partnership Act, mainly because of this confusion. TEX. REV. CIV. STAT. ANN. art. 6132b § 1.01 (Vernon 2006).

11. *Deere*, 198 S.W.3d at 100–01.

12. TEX. REV. CIV. STAT. ANN. art. 6132b, 1.01–11.05 (Vernon 2006) ("TRPA").

13. *Deere*, 198 S.W.3d at 101 (citing Coleman v. Coleman, 170 S.W. 3d 231(Tex. App.—Dallas 2005, pet. denied)). Also, as the court of appeals noted, TRPA section 1.01(12) states that a partnership can be written or oral. *Id.*

peals correctly concluded that the TRPA did apply, rejecting Ingram's argument that a partnership "at will" is governed by the common law and not by a statute.[14]

After reviewing TRPA provisions addressing both partner withdrawal and the events that trigger the "winding-up" process, the court of appeals concluded that none applied because Deere had not withdrawn.[15] In reaching that conclusion, the court of appeals found that the evidence, while disputed, was sufficient to support the jury's award of damages to Deere (equal to his share of net revenues) which the court of appeals equated to a jury finding that the partnership had, in fact, continued for that time.[16]

The court of appeals next considered whether Ingram owed or breached any fiduciary duties to Deere. Given the very long history of fiduciary duties in the partnership context, and the fact that the court of appeals acknowledged that fiduciary duties arise both from formal relationships (it cited trustee-beneficiary and attorney-client) and informal relationships of trust and confidence, it is remarkable that the court of appeals did not discuss, or even allude to, any of that long history.[17] A review of the brief submitted by Deere's lawyers confirms that they competently addressed the issue.[18] It is a mystery, then, that the court of appeals, quick to acknowledge that fiduciary duties arise from particular relationships, did not discuss the issue in the context of the parties' relationship as partners.[19] Indeed, using only the "trust and confidence/special relationship" analysis, the court of appeals concluded that "the record contains no evidence of a fiduciary relationship between Deere

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14. *Id.*

15. *Id.* at 101–02. The court of appeals also rejected Ingram's notions that (i) Deere's walkout was equivalent to a statutory "notice of an express will to withdraw" (TRPA § 6.01(b)( 1)), or (ii) that an ill-conceived "notice of the partner's expulsion" given by Ingram to Deere served as an event of withdrawal by Deere because TRPA § 6.01 requires that an expulsion be pursuant to the partnership agreement. TRPA §6.01(b)( 3). There was no such predicate here. *Id.* at 101–02. The court's discussion of the TRPA and its application did not apply because the court of appeals concluded that there was no withdrawal.

16. One cannot tell from the opinion exactly what happened, but given that Deere's status as a medical doctor was crucial to the clinic's ability to lawfully operate, it would have been interesting to know whether he was replaced with another medical doctor, whether that replacement was promised ownership, etc.

17. *See, e.g.*, Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928).

18. Brief of Appellant at 31–33, Deere v. Ingram, 198 S.W.3d 96 (Tex. App.—Dallas 2006, no pet.) (No. 05–05–0063).

19. There is a keen irony in this to this author, who has been involved with State Bar committees' efforts to achieve just that result: that partners, unlike trustees, do not owe the same fiduciary duty to one another that a trustee owes to its beneficiary. TRPA section 4.04 says just that, and the Bar comments explain the rationale (which includes that, unlike trustees, partners are owners dealing with their own interests, even if they might also be responsible for that of their partners). Courts have been slow to accept this, which Deere's counsel's brief discusses, citing the Texas Supreme Court decision in *M. R. Champion, Inc. v. Mizell*, 904 S.W.2d 617 (Tex. 1995), criticized by this author in this publication. Steven A. Waters, *Partnerships*, 49 SMU L. REV. 1205, 1209–12 (1996).

and Ingram."[20]

### 2. *Zinda v. McCann Street, Ltd.*[21]

Zinda was a limited partner in a limited partnership that owned and leased property to Zinda for a restaurant.[22] Zinda's gambling and options-trading losses led him to borrow money from his partners and pledge his limited partner's interest as collateral. Eventually, the lending partners foreclosed his ownership,[23] and Zinda brought claims of breach of fiduciary duty against the other limited partners.[24]

Citing the proposition that "[f]iduciary duties arise as a matter of law in certain formal relationships, including attorney-client, partnership and trustee relationships,"[25] the Texarkana Court of Appeals concluded that the other limited partners owed fiduciary duties to Zinda,[26] that those fiduciary duties included "a strict duty of good faith and candor,"[27] and that partners have a duty to one another to make full disclosure regarding matters affecting the partnership.[28] With respect to the disclosure issue, the court of appeals cited TRPA section 4.04 but did not acknowledge that the partnership was a limited partnership with one general partner. The court of appeals also failed to acknowledge that TRPA section 4.04 is from the "general partnership statute,"[29] or cite the "linkage" provision of the Texas Revised Limited Partnership Act[30] ("TRLPA"), section 13.03(b)( 2)( A), which provides that, to the extent not inconsistent with

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20. 198 S.W.3d 96 at 103. It would have been a beautiful thing if the court had cited to TRPA section 4.04, and said that there was no longer a fiduciary relationship, as such, based on the authority of that section. Nothing in the opinion suggested that it would have mattered given the finding on withdrawal; perhaps the fiduciary claim was a "backup plan" that turned out not to be needed.

21. 178 S.W.3d 883 (Tex. App.—Texarkana 2005, no pet.).

22. *Id.* at 887. Zinda had been the sole owner and operator of the restaurant at an earlier time; after it burned down, the partnership was formed to acquire the land from Zinda. It borrowed money to rebuild the restaurant, and then leased the restaurant property to Zinda for $7,500 per month for twenty years. *Id.*

23. Zinda complained that the partnership did not do this properly because the vehicle used was a deed of trust, which creates liens on real property, while a partnership interest is personal property. Zinda was right about those things, but a deed of trust document also often creates a security interest in personal property, which is apparently what the court relied on in upholding the foreclosure. *Id.* at 894.

24. *Id.* at 889-90. Ironically, it is Zinda whom the opinion paints as clearly the problem actor. Zinda claimed that the other partners withheld relevant partnership information from him, contrary to their fiduciary duties, when they were trying to decide what to do about *his* conduct. *See id.* at 890–91.

25. *Id.* at 890. *But see* Deere v. Ingram, 198 S.W.3d 96 (Tex. App.—Dallas 2006, no pet.).

26. *Zinda*, 178 S.W.3d at 890. The partners might have pursued the argument that limited partners do not, as such, owe fiduciary duties; apparently, there was no need to do that in view of the overwhelming evidence otherwise in their favor. In fact, it is not obvious that limited partners owe fiduciary duties, as such, at least if they do not participate in control of the partnership's business.

27. *Id.* at 891.

28. *Id.* at 890.

29. *Id.*

30. TEX. REV. CIV. STAT. ANN. art. 6132a § 1 (Vernon Supp. 2004–2005).

the TRLPA, the TRPA applies to the TRLPA.[31]

## B. Judicial Dissolution

### *1. Dunnagan v. Watson*[32]

A dispute arose between two limited partners of a limited partnership formed among three individuals, as limited partners, and a corporation organized and owned by them, as the general partner, to own a horse-racing facility. Dunnagan owned fifty percent (including his part of the general partner corporation) while Watson and Lawley shared the remaining half. Lawley eventually sold both his limited partner's interest and his shares in the corporate general partner, leaving Dunnagan and Watson as partners with approximately sixty percent and forty percent shares, respectively.[33]

Although the issue in the case—whether there was sufficient evidence to support a jury finding—dilutes the importance of the Fort Worth Court of Appeals' conclusion, the judicial dissolution element warrants coverage. The jury found, and the court of appeals agreed, that there was evidence to support the finding that Dunnagan's conduct implicated TRLPA section 8.02(2), which permits a court to dissolve a limited partnership if the court finds that "another partner has engaged in conduct relating to the limited partnership business that makes it not reasonably practicable to carry on the business in limited partnership with that partner."[34]

The partnership was organized to acquire a horse-racetrack facility, which it did, and seek a horse racing license, which was expected to take between three to six months.[35] In the meantime, two of the three initial partners wanted the partnership to operate an on-site restaurant; the third, Dunnagan, did not. After much debate, the parties agreed that Watson and Lawley would operate the restaurant, at their expense, and they did so. The only operations conducted by the partnership itself related to the facility's "backside," which consisted of the stable area and racetrack.[36] After sixteen months, Watson and Lawley also took on the operation of the backside, with the same understanding that it was for their, not the partnership's, account.[37] When the partnership failed to acquire a racing license (the bad news came a couple of months after Watson and Lawley assumed operation of the backside), the parties' relationship deteriorated: Watson asked the court for a judicial dissolution

31. § 13.03(b)( 2)( A).
32. 204 S.W.3d 30 (Tex. App.—Fort Worth 2006, pet. denied).
33. *Id.* at 34–35.
34. *Id.* at 38.
35. The effort to acquire the racing license took much longer than expected and was unsuccessful, which appears to have contributed, if not led, to the difficulties between Dunnagan and Watson.
36. Even without a license that permitted horse racing, horses could be stabled there and trained and exercised on the racetrack, producing some revenue for the partnership. But revenues do not equal profits.
37. *Dunnagan*, 204 S.W.3d at 35–36.

under TRLPA section 8.02(2); Dunnagan fought that and brought a claim of his own for breach of fiduciary duty by Watson. One interesting aspect of the opinion is the discussion of Watson's fiduciary duty, remembering the roles he undertook as a limited partner in the partnership, as an officer of the corporate general partner,[38] and as the operator of an on-site restaurant for his own account. The court of appeals discussing fiduciary duties arising from particular formal relationships, including partners in a partnership,[39] noted that fiduciary duties apply "to any person who occupies a position of peculiar confidence towards another,"[40] and then specifically mentioned the fiduciary relationship between a corporate officer or director and the corporation.[41]

Dismissing Dunnagan's claim that Watson could not seek a judicial dissolution because Watson did not have "clean hands,"[42] the jury found that Dunnagan's actions contributed to the impracticality of the partnership's continuation.[43] The partners, according to the court of appeals, were frustrated and exhausted by "the seemingly endless disagreements and discontent between Dunnagan and Watson."[44] Consequently, Watson successfully obtained a judicial dissolution of the partnership, over Dunnagan's objection. Surely, the case does not stand for the proposition that a partner who wants a judicial dissolution—knowing that the other partner does not—need only work to create, or at least foster, disharmony to "set up" that result. It is good to remember the procedural posture of this case—the appellate court worked hard, following existing procedural rules and precedent, to find support for the jury's findings.[45] Furthermore, the court of appeals also found support in the record for the jury's finding that Watson had breached fiduciary duties owed to the limited partnership.[46]

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38. *See id.* at 46–47.

39. *Dunnagan*, 204 S.W.3d at 46. *But see* Deere v. Ingram, 198 S.W.3d 96 (Tex. App.—Dallas 2006, no pet.).

40. *Dunnagan*, 204 S.W.3d at 46.

41. *Id.* Apparently, the trial court's charge to the jury mentioned both the trust/confidence relationship and, in much greater detail, the fiduciary duty owed by an officer or director. And the trial court's charge spoke in terms of fiduciary duties owed by the corporate officer (of the general partner) directly to the limited partnership. *Id.*

42. The basis was the conduct that resulted in the finding that Watson breached fiduciary duties, which included committing to obligations in the partnership name during the time that he was running the restaurant and backside for his own account. *Id.*

43. *Id.* at 41, 44.

44. *Id.* at 44. It is hard to know what all of this means. The jury found, and the court of appeals sustained, that Watson breached fiduciary duties and that Dunnagan did not. Yet, it was Dunnagan's actions that were found to support the judicial dissolution of the partnership. From the opinion, those actions included complaining that, after the application to acquire a racing license was denied, Watson did not want to pay rent to use the facilities for operating the restaurant and, generally, just disagreeing about what course the partnership should take without the racing license. *Id.* at 43.

45. The court of appeals also stated that Dunnagan did not demonstrate the harm to him of a judicial dissolution; he merely stated that he wanted to continue operations for five years to make a profit. *Id.* at 41–42.

46. Again, the number of hats worn by Watson make it difficult to say with conviction which hat sunk the boat. The headnotes of the reporter suggest that it was a limited partner who owed duties to the partnership in that capacity, but the opinion itself is much less

### 2. *Akuna Matata Investments v. Texas NOM Limited Partnership*[47]

After prevailing in its state court suit in a case reported in last year's Survey,[48] plaintiff brought this federal action to dissolve and terminate the partnership and to divide the partnership assets.[49] The real issue in the case was a procedural one: the res judicata effect of the state court case on plaintiff's ability to sustain this federal action.[50] But cases that involve a judicial dissolution request are rare enough to justify coverage of this one.

Hot on the heels of collecting on its state court victory, plaintiff filed suit in federal court seeking dissolution of the partnership and partition of the partnership property.[51] Defendants asserted that plaintiff's claims had been litigated in the state courts, and thus were barred by res judicata. Plaintiff countered that the dissolution request was a separate claim based on defendants' "unreasonable conduct" that made it impractical to continue with the partnership.[52]

Following established principles, the district court looked to Texas law, where the judgment in the prior case was rendered, to analyze the res judicata claim.[53] Of the three elements that must be established to sustain the res judicata claim, the one at issue here was that the second action be based on the same claims as the first action, or on claims that should previously have been raised.[54] Texas employs the "transactional approach" in determining the similarity and the barring effect of a litigated claim.[55] Under this approach, a claim is barred if the claim "arises out of the same subject matter of a previous suit and which through the exercise of diligence, could have been litigated in a prior suit."[56]

The district court found that the claims arose from different facts: the first action, in state court, was to determine the existence of the partnership and any resulting breaches of duty if that existence was established;[57] here, the claim arose out of the tense business relationship existing between the parties.[58] But the state court litigation did not involve dissolution and termination of the partnership. Consequently, the district court

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clear on that. Yes, that person was a limited partner, but it is not clear that he was acting as such when his conduct resulted in breach of a duty. In any case, he apparently was an officer but not a gentleman.

47. Akuna Matata Invs. v. Tex. NOM Ltd. P'ship, No. SA-05-CV-1053-RF, 2006 U.S. Dist. LEXIS 76788 (W.D. Tex. Sept. 28, 2006).

48. Steven A. Waters & Angela Lilly, *Partnerships*, 59 SMU L. REV. 1461, 1473–76 (2006).

49. *Akuna*, 2006 U.S. Dist. LEXIS 76788, at *5.

50. *Id.*

51. *Id.*

52. *Id.* at *5–6.

53. *Id.* at *11.

54. *Id.* at *12. The other two are (i) prior final judgment on the merits, and (ii) identity of parties, both undisputed here. *Id.*

55. *Id.* at *13.

56. *Id.* (citing Barr v. Resolution Trust Corp., 837 S.W.2d 627, 631, 635 (Tex. 1992)).

57. *Id.* at 16.

58. *Id.* at 15. That, alone, was sufficient to deny defendants' motion for summary judgment, according to the district court. *Id.*

found that the state court had not disposed of that claim, and that plaintiff's claim for dissolution was a separate action that did not arise from the previously litigated claim.[59]

When a partnership is between two people who no longer get along and one party recovers, it is difficult to imagine the survival of that business relationship, given that it is one usually built on trust and often involving a close working environment. So, why do we not see more of these judicial dissolution cases? Perhaps, the parties simply agree to discontinue as partners after their initial battle.

### C. Spousal Joinder—Does It Work?

#### 1. *In re Kirby Highland Lakes Surgery Center*[60]

For Texas partnerships with natural person partners, it is common to include in the partnership agreement a joinder to be signed by the non-partner spouse to ensure that the spouse's community property interest in the partnership interest of the partner-spouse is governed by the partnership agreement. Though the drafter certainly has reasonable expectations that such a joinder works, there is nothing like a court test. This case stands for the proposition that they can work.

Dr. Kirby and his spouse, Helen Kirby, operated an outpatient surgical center. They were approached by other doctors who wanted to buy the outpatient center and related assets, and become partners with Dr. Kirby. The two key agreements were a purchase and sale agreement ("PSA") and a partnership agreement. Importantly, the partnership agreement was attached to the PSA as an exhibit, and the two documents were to be signed concurrently as part of the sale of the outpatient center to the partnership. Helen was not a partner, but she signed a "Joinder of Spouses" addendum that purported to govern any community property interest that she might have in her husband's partnership interest.[61] The partnership agreement, but not the PSA, contained an arbitration clause for the resolution of disputes arising under or "related to" the agreement.[62] Under the PSA, the Kirbys sold, and financed with seller-financing, the outpatient center's real estate and related equipment.

After the partnership discontinued payments required by the PSA to be made to the Kirbys for the acquired assets,[63] the Kirbys filed suit in state district court for breach of the PSA.[64] The district court denied the partnership's motion to compel arbitration, holding that the dispute was governed by the PSA, not the partnership agreement, and that Helen was not bound by the arbitration clause. The partnership appealed, arguing

59. *Id.* at 19.

60. *In re* Kirby Highland Lakes Surgery Ctr., 183 S.W.3d 891 (Tex. App.—Austin 2006, no pet.).

61. *Id.* at 893.

62. *Id.*

63. The partnership invoked a concern that the payments violated federal anti-kickback laws.

64. 183 S.W.3d at 894.

that the partnership agreement was effectively incorporated into the PSA or, alternatively, that the dispute arose under or was *related to* the partnership agreement. Therefore, they argued, the arbitration clause controlled, and Helen was bound to the arbitration clause via the joinder that she signed.[65]

Anyone interested in the arbitration issues, which included whether state or federal law applied,[66] should consult the case. On the issue of whether the joinder was effective to bind the non-partner spouse to the arbitration clause, the Austin Court of Appeals found that it did bind her; Helen's submission of her community property interest to the provisions of the partnership agreement included the arbitration clause.[67]

### D. Service of Process on a Limited Partnership

#### *1. Allodial Limited Partnership v. Susan Barilich, P.C.*[68]

While a botched effort to effect service of process and the consequences to a default judgment ordinarily would not be sufficiently interesting to warrant coverage here, an occasional reminder that reading and complying with statutes and the rules of civil procedure (and stating everything clearly in one's pleadings to the court!) is a good thing.

Law Firm sued Limited Partnership for unpaid legal fees and obtained a summary judgment. Thinking that it was following the process spelled out in the TRLPA, Law Firm served Limited Partnership through the Texas Secretary of State, alleging that, although Limited Partnership's principal place of business was in Dallas County, Texas, it did not have a registered agent for service of process in Texas and thus could be served with process through the Office of the Texas Secretary of State.[69] The Secretary of State's notice was returned as undeliverable, Limited Partnership did not participate in the trial, and a default judgment was entered in favor of Law Firm. Limited Partnership appealed, claiming that the lower court did not have personal jurisdiction over it.[70]

Limited Partnership contended that the trial court lacked personal jurisdiction because Law Firm did not strictly comply with the statutory

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65. *Id.* at 894.

66. State law governed whether an arbitration agreement was formed, and the Federal Arbitration Act governed otherwise, including whether the "related to" language in the arbitration clause, when taken with the close nexus of the PSA and the partnership agreement, was enough for the arbitration clause in the partnership agreement to govern a dispute under the PSA. *Id.* at 895-96 (discussing requirements to compel arbitration under the Federal Arbitration Act).

67. *Id.* at 903.

68. 184 S.W.3d 405 (Tex. App.—Dallas 2006, no pet.).

69. The process is different under TRLPA for domestic and foreign limited partnerships. In either case, under the right circumstances and as a substitute for direct service, service can be made on the Texas Secretary of State. Tex. Rev. Civ. Stat. Ann. art. 6132a § 9.10 (Vernon Supp. 2004–2005) (domestic and foreign respectively). Here, notice was served on the Texas Secretary of State, which then sent notice by registered mail, return receipt requested, to Limited Partnership's Las Vegas, Nevada home office. *Allodial*, 184 S.W.3d at 407.

70. *Allodial*, 184 S.W.3d at 407.

requirements of TRLPA section 1.08, which governs service by the Secretary of State, by failing to exercise the required reasonable diligence in attempting to serve Limited Partnership before effecting service via the Texas Secretary of State.[71] Law Firm countered that section 1.08 governed substituted service only for *domestic* limited partnerships and that its request for service of process on Limited Partnership through the Texas Secretary of State was proper under both section 9.10 of the TRLPA, which applied to *foreign* limited partnerships, and section 17.044 of the Texas Civil Practice and Remedies Code.[72]

In beginning its review of the lower court's summary judgment, the Dallas Court of Appeals noted that it could rely only on the record for jurisdictional facts. Unlike other procedural contexts, where indulging inferences and presumptions is required, here the court of appeals was barred from making inferences, and it was the plaintiff's burden to allege sufficient jurisdictional facts to bring the defendant within the statutory provisions relied on for service.[73] The court of appeals noted that Law Firm's pleadings alleged only that Limited Partnership was a limited partnership, and made no direct assertion that Limited Partnership was a foreign or domestic limited partnership.[74] Because Law Firm relied on the Secretary of State for service, the record was required to show that (1) Limited Partnership was amenable to service in this manner, and (2) Limited Partnership was served in the manner required by statute.[75] Because the pleadings were insufficient to determine the limited partnership's status as domestic or foreign, the court of appeals looked at both cited TRLPA sections.[76]

First, the court of appeals reviewed the requirements for service on a *domestic* limited partnership under the TRLPA. The court of appeals stated that although section 1.08 governs service of process on domestic limited partnerships that have not appointed a registered Texas agent, a plaintiff must first exercise reasonable diligence in locating and serving a general partner before relying on the Secretary of State for service.[77] The record here contained no such showing.[78] Plaintiff did not comply with section 1.08 (if it even applied, and it should not have on the full facts).[79]

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71. *Id.* at 408.

72. *Id.* Section 9.10 of the TRLPA concerns service on foreign limited partnerships, and Section 17.044 of the Texas Civil Practice and Remedies Code concerns substituted service on nonresidents.

73. *Id.* at 407-08. This was a "restricted appeal," which is a direct attack on the trial court's judgment, one prerequisite of which is that the error must be apparent on the face of the trial court record. *Id.*

74. *Id.* at 408. The court of appeals acknowledged that both parties agreed that Limited Partnership was a foreign limited partnership; however, in this context, the court of appeals was obliged to look solely to the record available to the trial court at the time of the default judgment. *Id.* at 408 n.1.

75. *Id.*

76. *Id.*

77. *Id.* at 408–09.

78. *Id.* at 409.

79. *See id.*

The court of appeals listed the four instances in which section 9.10 of the TRLPA applies to service of process on a *foreign* limited partnership: (1) no registered agent in Texas; (2) even with reasonable due diligence, the registered agent could not be found at the registered office; (3) the limited partnership's registration was cancelled; or (4) the limited partnership transacted business in this state without registering as required under TRLPA 9.10(b).[80] Here, it was not the failure to comply with section 9.10,[81] but, rather, the incomplete record[82] that did not allow the court to apply section 9.10.[83] Therefore, Law Firm failed to demonstrate that section 9.10 applied to the facts in the record.[84]

The lessons for the day from this case are to read the statute, to comply with the statute, and to clearly connect the facts of your case to the statute.

## E. Redemption of Partnership Interest

### *1. Coleman v. Coleman*[85]

When a partner of a Texas general partnership dies, and there is not a written partnership agreement to determine what happens, the TRPA is supposed to fill the void. How it does that is not always crystal clear. And when there is enough money involved . . . well, that is why the courts are in business.

Robert Coleman and his brother Max Coleman were equal partners in a business, Coleman Properties. After Robert died, Max continued operating the business and sending Robert's salary to his widow, Debbie Coleman, and paying certain expenses for her. Debbie sought to be paid the value of Robert's partnership interest, insisting that the business be wound up, and the proceeds distributed. Max continued operating the business and changed the name to Coleman Logistics. Thereafter, Debbie brought suit against Max seeking the redemption value of Robert's partnership interest.[86] The trial court ruled in favor of Debbie.[87]

On appeal, Max first argued that, as a transferee,[88] Debbie was not

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80. *Id.*

81. It was complied with because Limited Partnership did not have a registered agent in Texas, triggering the application of clause (1).

82. Law Firm's petition asserted that Limited Partnership could be served at its home-principal office in Las Vegas, Nevada, but did not allege that Limited Partnership was a foreign limited partnership formed in Nevada. *Allodial*, 184 S.W.3d at 409.

83. *See id.*

84. *See id.*

85. 170 S.W.3d 231 (Tex. App.—Dallas 2005, pet. denied).

86. *Id.* at 235.

87. *Id.* Specifically, the trial court held: (1) Max failed to wind up the business after Debbie's request to do so; (2) Debbie was entitled to the redemption price of Robert's interest; and (3) Max failed to tender the redemption price. The trial court reduced the redemption price by fifteen percent for "lack of control," i.e., Debbie was not a partner but a transferee. *Id.*

88. Indeed, and as the court of appeals noted, under TRPA section 5.04(b), a deceased partner's surviving spouse is treated for purposes of the TRPA as the transferee of the deceased partner's interest in the partnership. *Id.* at 237.

entitled to the redemption price by statute, but instead only to the balance in Robert's capital account at the time of his death.[89] The parties agreed that Coleman Properties was an oral partnership at will with no written agreement to guide what should happen when there was a withdrawal of a partner.[90] As noted above in the discussion of the *Allodial* case, the statute (here, the TRPA) fills in the gaps left by the parties, and, in the case of an oral partnership, it effectively becomes the agreement.[91] The Dallas Court of Appeals said that the TRPA provides two methods for a withdrawn partner[92] to be paid the value of its partnership interest: (1) via receiving its share from a distribution of assets after the partnership's business is wound up; or (2) if the business continues, via a redemption of its interest by the partnership under TRPA section 7.01.[93]

Section 8.01, which spells out the various events that require a partnership to be wound up, provides that a wind-up request from a partner of a partnership at will is one such event.[94] After the partnership is wound up, creditors are paid and accounts among the partners are settled, and any resulting profits or losses are credited or charged to the partners' capital accounts.[95] But if the business is continued, then TRPA section 7.01 comes into play, requiring the partnership to buy the withdrawn partner's interest at a redemption price that equals the fair market value on the date of withdrawal.[96]

Max argued that TRPA section 7.01(a) only entitled *partners* to be paid the redemption price, which excluded Debbie, a mere *transferee*. Max further asserted that section 7.01(n) was the only provision that provided for a transferee to be able to have her interest redeemed, but that section 7.01(n) did not apply to partnerships at will. Therefore, Max concluded that Debbie, at most, was entitled to any "positive balance" in Robert's capital account under section 8.06(b)'s winding-up provisions.[97] This argument was easy for the court of appeals to reject—Robert failed to liquidate the business ("wind up"), then sought to force a twisted interpretation of a winding-up provision on the other party. The court of appeals agreed that, on its face, TRPA section 7.01(n) does not apply to partnerships at will.[98] However, the court of appeals found that the over-

89. *Id.* at 235.

90. *Id.* at 236. "Event of withdrawal" does not always include the affirmative conduct that "withdrawal" suggests. The death of a partner is an event of withdrawal of that partner under TRPA section 6.01(b)( 7)( A). *Id.* at 237.

91. *See id.* at 236.

92. Again, a deceased partner is a withdrawn partner. TEX. REV. CIV. STAT. ANN. art. 6132b § 6.01(b)( 7)( A) (Vernon 2006) ("TRPA").

93. *Id.* at 236. TRPA § 7.01(a) requires a redemption on the occurrence of an event of withdrawal, if an event requiring a winding up does not occur within sixty days after the withdrawal. TRPA § 7.01(a).

94. TRPA § 8.01(g). It also provides that a majority-in-interest of the other partners may elect to continue the partnership and that continuation without settlement or liquidation is considered to be such an election. *Id.*

95. TRPA § 8.06(a)–( b).

96. TRPA § 7.01(a); 170 S.W.3d at 237 .

97. 170 S.W.3d at 237.

98. *Id.* at 238.

all structure of the TRPA intended that the value of a partnership interest be recoverable in one of the two ways discussed above.[99] Consequently, because Max did not wind up the partnership, the court of appeals found that the remaining option must apply (redemption).[100] Max was required to buy out Robert's partnership interest at the redemption value at the time of his death.[101]

## III. LIMITED LIABILITY CASES

### A. NATURE OF LLC INTEREST

#### *1. In re Delta Starr Broadcasting*[102]

While we ordinarily would not be interested in a case involving Louisiana law and a Louisiana court, limited liability company case law is still relatively sparse, so looking to another state occasionally is warranted. Delta Starr Broadcasting, L.L.C. was a Louisiana limited liability company (the "LLC") with three equal members.[103] One member filed a voluntary Chapter 11 bankruptcy petition on behalf of the LLC, asserting authority to do so based on gaining approval by two of the entity's three members.[104] The third member filed a motion to dismiss the petition, on the basis that proper authorization had not been obtained, for two reasons: (1) before the second member gave its apparent consent, it transferred its membership interest to a holding company controlled by the third member (the objecting member); and (2), even if the second member had still been a member when giving his purported consent, that approval was invalid because it was not given at a properly-convened meeting of the members. The bankruptcy court agreed with the third member on the second ground, that the action had not been approved at a formal meeting of the members, and it dismissed the case for lack of authority to file the petition.[105]

The first member, the one who filed the bankruptcy petition, appealed the ruling, arguing that the second member's sale of its interest did not

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99. *Id.*

100. *Id.* The court of appeals indicated that the legislative intent was clear and that under § 7.01(a), had Robert chosen to withdraw while living, the partnership would have been required to buy him out. The court of appeals "[saw] no need to read the provisions governing redemption so narrowly as to deny" Debbie the right to recover the redemption price when the surviving partner utilized the partnership assets to continue the business operation. *Id.* at 238.

101. *Id.* at 238. The parties fought about the valuation and whether life insurance policies were available to fund the buy-out, among other things not pertinent to this discussion. *Id.* at 238–42.

102. *In re* Delta Starr Broad., L.L.C., 2006 U.S. Dist. LEXIS 4477 (E.D. La. Feb. 3, 2006).

103. *Delta Starr*, 2006 U.S. Dist. LEXIS 4477, at *2.

104. In the opinion's description of the parties' arguments, there is no mention of either party's pointing to an LLC agreement or a statute in support of the need for two of three members to approve the action. But the district court did get to that, pointing to the default majority vote provision of LA. REV. STAT. ANN. section 12:1318(A) and (B). *Id.* at *9–10.

105. *Id.* at *3.

include a transfer of full membership or voting rights and that no formal meeting was required to approve the filing.[106] The federal district court concluded that it must look to the law of the entity's state of organization, Louisiana in this case, to determine the validity of the bankruptcy petition.[107]

The district court first addressed whether the second member had voting rights on the day it consented to the bankruptcy filing.[108] Louisiana LLC law[109] provides that when a member assigns its membership interest, the assignee may not exercise any membership rights until the assignee is properly admitted as a member.[110] Additionally, absent contrary agreement in governing documents of the LLC,[111] an assignee of a membership interest can become a substituted member only with written unanimous consent of the members, and, until that time, the assignor continues to be the member with the attendant rights (such as voting and management).[112] The non-filing member argued that because he controlled the assignee holding company and was already a member himself, the assignee was not, in fact, a "new" member; therefore, he argued that he was entitled to exercise all membership rights. The district court rejected that argument and held that the second member retained his voting rights because the assignee had not been duly admitted as a member.[113] Therefore, he did not have the full attendant rights, including voting.[114]

The district court then addressed whether, with the vote of two of the three members in hand, the filing member had the authority to file for bankruptcy on behalf of the LLC.[115] The district court found that Louisiana law required that the filing of a bankruptcy petition be authorized by

106. *Id.* at *4.
107. *Id.* at *5.
108. *Id.* at *6.
109. LA. REV. STAT. ANN. § 12:1301–1369 (2007).
110. § 12:1330. The same result is obtained under the Texas Limited Liability Company Act, art. 1528n and art. 4.05(2).
111. As in the partnership arena, there typically is great flexibility to vary by contract a result that would be obtained from application of the statute alone. It is sometimes said that the role of the unincorporated business entity statutes is to "fill in the gaps" left by the parties' agreement. The same result is obtained under the Texas Limited Liability Company Act, art. 2.09.A. and TRPA section 1.03.
112. LA. REV. STAT. ANN. § 12:1332 (2007). For the same result, see Texas Limited Liability Company Act, art. 4.05(4). Also, Texas Business Organizations Code ("TBOC"), section 101.108(b)( 2)( A) does not allow an assignee of a membership interest to participate in the management and affairs of the LLC, which requires a vote of all members (§ 101.109(b)).
113. *Delta Starr*, 2006 U.S. Dist. LEXIS 4477, at *7-8.
114. *Id.* It is important to note that, absent something in the organization's constituent documents, voting rights do not disappear on the assignment of a member's interest—they either travel to the assignee or remain with the assignor. Though it may seem inconsistent with the presumed intent of an assignor and assignee for the assignor to retain an important right, such as voting, there are the other members to consider. And, in this situation, the other member was required to approve the transfer of the voting rights and had not done so. The agreement *could* have authorized a transferor to make its transferee a substitute member.
115. *Id.* at *9–16.

a majority of the members, unless the articles of organization or the operating agreement state otherwise.[116] So, the requirement was met. The appeal therefore turned on whether Louisiana law requires business formalities, e.g., formal vote, resolution, meeting, etc., before members may act on behalf of the LLC.[117] The district court held that the legislature intended to keep Louisiana's LLC law flexible and, for contrast, pointed to the state's corporate law, which contains much stricter language requiring various formalities.[118] The district court concluded that Louisiana LLC law did not require that, to be effective, member approvals be given at a meeting or in another formal manner, though the parties could have stipulated that in their organization documents.[119] The district court reversed the dismissal and remanded the case.[120]

### 2. *In re HSM Kennewick, L.P.*[121]

This case is instructive on the nature of a LLC member's interest, contrasted with whether the member has an interest in property owned by the LLC. The ninety-percent member ("Debtor") of a two-member Washington state LLC (the "Company") filed for personal bankruptcy because of lender pressure relating to Debtor's having pledged its membership interest to support Company indebtedness.

About ten weeks after the personal filing, Debtor filed a bankruptcy petition on behalf of the Company, which the court dismissed for lack of authority of the Debtor.[122] On the next day, the ten-percent member filed a state court receivership action against the Company. Debtor challenged that filing on the basis that it violated the bankruptcy automatic stay,[123] asserting that the receivership action affected Debtor's property interest in the Company.[124] The issue before the bankruptcy court, therefore, was whether the automatic stay of Bankruptcy Code section 362 in

116. *Id.* at *10. Subdivision (A) is the basic default to majority, and subdivision (B) is for "big deal" items like property transfers. Subdivision (B) requires a majority vote of members even if there is a manager to otherwise run the show. LA. REV. STAT. ANN. § 12:1318. The court equated a bankruptcy to a property transfer because all property owned by the debtor is "transferred" to the bankruptcy estate. For a similar result under Texas law, see Texas Limited Liability Company Act, Article 2.23.D (unless the constituent documents provide otherwise, a vote of a majority is required to . . . (3) authorize any act that would make it impossible to carry on the ordinary business of the LLC), and Article E (unless the constituent documents provide otherwise, majority vote required to take any action that is not apparently for carrying on the business of the limited liability company in the usual way). Also, the new TBOC, in section 101.355, requires a majority vote unless otherwise provided in the Code, which would include section 101.356(c).

117. Delta Starr, 2006 U.S. Dist. LEXIS 4477, at *12.

118. *Id.* at *12-15.

119. *Id.*

120. *Id.* at *15.

121. 347 B.R. 569 (Bankr. N.D. Tex. 2006).

122. *Id.* at 57–71. The court did not elaborate on this ruling, saying only that the Debtor "did not have the requisite corporate authority." *Id.* at 571. Presumably, the court was using "corporate authority" in a more generic sense to mean authority to act for and bind the entity (in this case, a limited liability company).

123. 11.U.S.C. § 362 (2007).

124. *Kennewick*, 347 B.R. at 571.

the Debtor's bankruptcy case prohibited the second member from filing the receivership action against the Company, which was not in bankruptcy.[125]

The knee-jerk reaction would be that the receivership was filed against one not in bankruptcy, so the automatic stay does not come into play. But the bankruptcy court went through a more complete analysis, beginning with corporate law: a corporation and its shareholders are separate entities, with title to corporate property vested in the corporation, not the shareholders.[126] The bankruptcy court then discussed partnership law as it related to LLCs, advising that Washington state courts apply partnership law in determining the rights to assets of an LLC.[127] Partners, similar to shareholders under corporate law, have no interest in the individual assets of a partnership; instead, the interest represents that partner's share in remaining funds after all debts are paid and accounts settled.[128] As the bankruptcy court noted, almost in passing, Washington's LLC Act also states that an interest in an LLC is personal property and that a member has no interest in any specific LLC property.[129] Therefore, Debtor had no direct interest in the assets of the Company, and the bankruptcy court held that the other member's receivership action did not violate the Bankruptcy Code's automatic stay provision.[130]

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125. *Id.*

126. *Id.* at 571.

127. *Id.* LLCs are new and it is common for courts and others to consult partnership common law for guidance when unable to find it directly. Such consultation seemed unnecessary here. The cases cited by the court make it clear that the Washington courts seek that partnership law guidance when they cannot find it in the limited liability company law. *See* BP Land & Cattle, LLC v. Balcom & Moe, Inc., 86 P.3d 788, 790 (Wash. Ct. App. 2004); Koh v. Inno-Pacific Holdings, Ltd., 54 P.3d 1270-72 (Wash. Ct. App. 2002).

128. *Kennewick*, 347 B.R. at 572.

129. *Id.*; WASH. REV. CODE ANN. § 25.15.245(1) (West 2006). It seems odd that the bankruptcy court would feel the need to look to corporation or partnership law on this issue, given the direct coverage by the LLC statute. Perhaps it was merely buttressing the statute with common law that would have been consulted in the absence of statutory coverage.

130. *Kennewick*, 347 B.R. at 572. Citing the Bankruptcy Code's legislative history, the bankruptcy court noted that the policy of the automatic stay is "to prevent dismemberment of the estate and to enable an orderly distribution of the debtor's assets." *Id.* at 572 (quoting the Bankruptcy Code legislative history, H.R. Rep. No. 595, 95th Cong. 1st Sess. 341 (1977)). The bankruptcy court found no such dismemberment or any interference with the reorganization proceeding. *Id.* at 572. Interestingly, the member who filed the receivership apparently conceded that the receivership could adversely affect the Debtor, but argued "that the automatic stay does not extend far enough to protect a member in a limited liability company from an action that would adversely affect the value of the member's interest." *Id.* at 571. The court agreed. *Id.* at 572. Without knowing what the receivership asked for, one might have speculated that the receivership might even benefit the LLC and, therefore, the members and their interests as well as the estate of the Debtor. Apparently, from the other member's mouth, that was not the likely result here.