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Partnerships

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PARTNERSHIPS

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I. INTRODUCTION

THIS was not a particularly fruitful year in the partnership area. But the Texas Supreme Court did render a decision worthy of note, which does not happen every Survey period.

II. CASES

A. CAPACITY TO SUE IN TEXAS—WHEN DOES A FOREIGN LIMITED PARTNERSHIP HAVE CAPACITY TO SUE?—*COASTAL LIQUIDS TRANSPORTATION, L.P. v. HARRIS COUNTY APPRAISAL DISTRICT*[1]

In *Coastal Liquids*, the issue was whether a foreign limited partnership had capacity to sue in Texas.[2] Coastal was a Delaware limited partnership that had been doing business in Texas since 1993 but registered as a foreign limited partnership for the first time on June 27, 1995.[3] Coastal processed natural gas products from its Harris County facility and used underground domes to store liquid natural gas and other products. In 1994, the Harris County Appraisal District (the "District") separately listed and taxed the storage domes as "improvements."[4] The case is about Coastal's efforts to challenge the District's position.

Although the Court felt that a full discussion of the administrative and lower court proceedings was important to its decision, a substantially condensed version is offered here. Coastal protested the District's appraisals

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1. 46 S.W.3d 880 (Tex. 2001).

2. *Id.* at 882. The dissent, written by Justice Hecht, suggested that the *real* issue, which he was dismayed the Court never reached, was whether an underground salt-dome cavern used to store petroleum products is "land" or an "improvement." The Tax Code requires that each be appraised separately. *Id.* at 886.

3. *Id.* at 882. This proved to be important, because under Section 9.07(a) of the Texas Revised Limited Partnership Act, a foreign limited partnership (i.e., one organized under law other than Texas law) may not "maintain an action, suit, or proceeding in Texas until it has registered in Texas and paid to the secretary of state all amounts owing under Subsection (d) of this section." TEX. REV. CIV. STAT. ANN. art. 6132a-1, § 9.07(a) (Vernon Supp. 2001). But an exception allows a foreign limited partnership to *defend* an action without being registered. *Id.*

4. *Coastal Liquids*, 46 S.W.3d at 882. Justice Hecht said that "we were told by the parties and assured by numerous amici curiae [that this] was a legal issue important to Texas jurisprudence, ..." *Id.* at 886.

for 1994 and 1995,[5] and pursued the prerequisite administrative avenues through the Harris County Appraisal Review Board and then appealed the adverse result to the district court. In a second amended summary judgment motion, the District invoked Texas Revised Limited Partnership Act ("TRLPA") Section 9.07(a)[6] to support its position that Coastal lacked capacity to challenge the District's action for either 1994 or 1995 because of the timing of its registration and its statement that it would not commence business in Texas until July 1, 1995.[7] Without giving a reason, the district court granted the District's motion for 1994 and Coastal's for 1995; both parties appealed.[8]

The court of appeals initially dismissed the case for both 1994 and 1995 because "Coastal failed to show that it had ever properly registered [in Texas] as a foreign limited partnership."[9] Coastal filed a motion for rehearing, arguing that applying TRLPA Sec. 9.07(a) to deny it to be heard would be taking its property without due process and, alternatively, that the exception in 9.07(a) that permitted *defensive* actions applied to this situation.[10] Coastal also sought remand to allow it the opportunity to show that it had taken the steps necessary to register and pay all required fees. The court of appeals denied the remand but did agree that Coastal's action was defensive and, therefore, was within the exception of 9.07(a), and affirmed the trial court. Again, both parties sought review by the next court, in this case the Texas Supreme Court.[11]

The Court discussed the requirements that had to be met by a foreign limited partnership, which conducted business before it properly registered, if that partnership wanted to maintain a suit in Texas. TRLPA Sec. 9.07(d) requires payment of both the original registration fee *and* $750 per year for each year or partial year in which the foreign limited partnership conducted business in Texas without having been registered.[12] The Court found that Coastal had not submitted evidence that it had made any such payment for calendar years 1993 and 1994, in both of which years it was doing business in Texas.[13] The Court concluded that Coastal had not done what was necessary to maintain an action for either 1994 or

5. There was considerable stopping and starting to get to this result. First there was filing for 1994 only; an amended petition included 1995; the District argued that Coastal could not maintain the action for 1994 because it had not registered in that year; Coastal responded that it cured that by registering in 1995; the District countered with the argument that Coastal could not maintain its suit for either year because, when Coastal filed its application on June 27, 1995, it stated that July 1, 1995, was the first date that it would conduct business in Texas. *Id.* at 882-83.

6. *See* discussion *supra* note 3.

7. *Coastal Liquids*, 46 S.W.3d at 883.

8. *Id.* This made Coastal the appellant for 1994 and the District the appellant for 1995. *Id.*

9. *Id.*

10. *Id.* at 884-85.

11. *Coastal Liquids*, 46 S.W.3d at 883. In accepting petitions from both parties, the Court said that when it does so in a summary judgment context, it renders the judgment that should have been rendered by the trial court. *Id.* at 884.

12. TEX. REV. CIV. STAT. ANN. art. 6132a-1, § 9.07(d) (Vernon Supp. 2001).

13. *Coastal Liquids*, 46 S.W.3d at 884.

1995 and that, therefore, TRLPA Sec. 9.07 deprived "Coastal of its authority to sue."[14] The Court acknowledged that both the Bar Committee comments on this part of the TRLPA and case law construing the analogous provisions of the Texas Business Corporation Act specifically contemplated that a "post facto" cure of a failed registration could be made, supporting capacity to maintain a suit after that cure even as to an earlier point in time. However, Coastal did not carry its burden here by fully curing the failure and demonstrating that *before* it got to the Supreme Court.[15]

B. JOINT AND SEVERAL LIABILITY OF GENERAL PARTNERS—*HELPINSTILL V. REGIONS BANK*[16]

It is axiomatic that general partners have joint and several liability for the obligations of a general partnership.[17] It is equally axiomatic that one should be careful in picking one's partners. Here, one ended up in prison and the other stuck with liability to a bank.

Helpinstill and Brown were partners in a general partnership, MBO. They maintained an MBO bank account at Longview National Bank (predecessor to Regions Bank).[18] Brown ran the business, including managing the bank account. Over a period of time, Brown engaged in a consistent practice of overdrawing the account and then later covering the shortfall with new deposits. It appeared to be cash flow management of some sort. Even Helpinstill admitted that this was ordinary course of business activity.[19] But Brown eventually extended this to a check-kiting scheme,[20] which resulted in the account becoming terminally overdrawn.

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14. *Id.* at 885. The Court noted that both parties had approached the issue as one of *standing* when the real issue was *capacity*. The Court said that standing exists when a party is aggrieved, as Coastal was here, but it found that while standing was necessary, it was not sufficient, and that a party with standing also must have capacity. *Id.* at 884.

15. *Coastal Liquids*, 46 S.W.3d at 885. The Court also noted that Coastal did not challenge, in the court of appeals, the denial of its motion to demonstrate that it had, in fact, paid all required fees. Justice Hecht was particularly annoyed by the disposition of the fee payment issue. First, he noted that the issue was never raised in the trial court, where Coastal could have then proved that it had already paid, or cured its failure to have done so. *Id.* at 887. Nevertheless, that became the dispositive issue in the supreme court. Adding insult to injury, the Court refused to consider two Coastal arguments because they were not made in the trial court. Hecht found this double whammy to be "inexplicably unfair." *Id.* at 888.

16. 33 S.W.3d 401 (Tex. App.—Texarkana 2000, pet denied).

17. TEX. REV. CIV. STAT. ANN. art. 6132b–3.04 (Vernon Supp. 2001) ["TRPA"].

18. *Helpinstill*, 33 S.W.3d at 403. The court made a statement at this point that confused one critical aspect of this case—the court said that each partner agreed that he would be individually liable to the bank for any overdrafts on this account. This is important because the balance of the case suggests that the joint and several liability principle that nabbed Helpinstill resulted from his status as a general partner; the court's statement (that the parties *agreed* to be liable), if meant literally, would produce the result that liability was a matter of *contract*, which would have been a much different result.

19. *Id.* at 404.

20. WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 663 (9th ed. 1999) defines a "kite" to be "a check drawn against uncollected funds in a bank account . . . ." So, when an unintentional overdraft becomes an intentional scheme to steal money from a bank, a "kiting" scheme has occurred.

The bank sued Helpinstill to recover the shortfall of $381,011.15 and obtained a judgment. Helpinstill's principal argument on appeal was that, when Brown's activity was extended to check-kiting, it ceased to be in the "ordinary course of business" of MBO. Furthermore, Helpinstill did not know of Brown's check-kiting and did not ratify that action.[21] Too bad. The court methodically rejected all of Helpinstill's arguments of trial court error[22] and held that Helpinstill was liable as a matter of law because he was a general partner and the obligation to the bank for the overdraft was a partnership liability, citing TRPA Section 3.04.[23] Although the court did not say so, it clearly was making the policy judgment that, as between the bank and Helpinstill, the latter was responsible for the actions of his partner.

C. ELEMENTS OF A JOINT VENTURE—LOSS-SHARING REQUIRED—*SWINEHART V. STUBBEMAN, MCRAE, SEALY, LAUGHLIN & BROWDER, INC.*[24]

This was a legal malpractice case,[25] but the relevant issues for this Survey are not directly related to that. Plaintiff Swinehart was a petroleum geologist who contracted with Haber Oil, an oil and gas development company, to provide typical services to help Haber find oil and gas. The contract entitled Swinehart to a monthly cash payment and to half of the mineral or royalty interests retained by Haber after it gave up whatever was necessary to attract investors. Swinehart's efforts were successful and drilling produced "significant amounts of oil and gas on some of the leases."[26] Haber paid Swinehart his retainer and assigned to him an ownership interest, but he terminated the relationship before, according to Swinehart, it had assigned the full interest that Swinehart had earned under his contracts with Haber.[27] Swinehart filed suit.

Swinehart argued that his relationship with Haber went beyond that of mere parties to a contract; he asserted that they were joint venturers to support his effort to have the court impose a constructive trust on the fruits of Haber's development activities.[28] The court explained that a constructive trust was an equitable remedy designed to prevent unjust

21. *Helpinstill*, 33 S.W.3d at 404.

22. For example, the Court easily found that Brown's act of creating overdrafts was in the ordinary course of MBO's business and benefited MBO (even when it triggered Helpinstill's liability), even though it acknowledged that the business did not include the check-kiting scheme. *Id.*

23. *Helpinstill*, 33 S.W.3d at 404.

24. 48 S.W. 3d 865 (Tex. App.—Houston [14th Dist.] 2001, pet. denied).

25. *Id.* at 873. Swinehart was unhappy with the handling of a state court suit and related bankruptcy case. The bankruptcy court found in Swinehart's favor, and the federal district court upheld those findings. But the Fifth Circuit essentially said that Swinehart failed to do many necessary things in his legal proceedings to support his position, and it reversed. The parties settled for much less than Swinehart had been awarded by the lower courts. *Id.* at 872-73.

26. *Id.* at 871.

27. *Id.*

28. *Swinehart*, 48 S.W.3d at 878.

enrichment and that it can be based on a fiduciary relationship, such as one that exists as a matter of law between partners or joint venturers.[29] The court analyzed Swinehart's joint venture argument under the long-standing four element test applied by Texas courts, which have held that there must be present in the relationship: "(i) a community of interest, (ii) an agreement to share profits, (iii) an *agreement to share losses*, and (iv) a mutual right of control or management."[30] The court found no evidence to support an agreement of the parties to share losses; therefore, there was no basis to find a joint venture.[31]

III. LEGISLATION

The Survey period included a legislative session. Not much happened in the partnership or limited liability company area, but there were a few notable changes.

A. TEXAS REVISED LIMITED PARTNERSHIP ACT.

Senate Bill 1320[32] effected a few changes in the TRLPA, a couple of which are worth mentioning. Section 1.06 was revised to eliminate the requirement that, on change of a registered office, a particular required statement be *verified.* It is no longer required to be verified, only signed.[33] More importantly, Section 6.01(b) of the TRPA, which defines the events of withdrawal of a partner, was revised to add a new subparagraph (11) to provide that withdrawal occurs on the conversion of the partnership into a different form (e.g., limited liability company, corporation), if the partner did not consent to the conversion and did not notify the partnership in writing of the partner's desire not to withdraw within 60 days after the later of the effective date of the conversion or the date the partner receives actual notice of the conversion.[34] In addition, a complementary new subsection (c) was added to Section 6.01, providing that a withdrawal of a partner on a conversion is effective immediately before the effective date of the conversion and is not considered to be a wrong-

29. *Id.*

30. *Id.* at 879 (citing Ayco Dev. Corp. v. G.E.T. Serv. Co., 616 S.W.2d 184, 186 (Tex. 1981) (emphasis added)). The loss-sharing element is a unique, common law element, which Texas courts have limited to joint ventures.

31. *Swinehart*, 48 S.W.3d at 879. The court also declined to find an informal *confidential* relationship, which also could have supported the imposition of a constructive trust. *Id.* at 882. Interestingly, TRPA § 2.02(a) defines a "partnership" to be an "an association of two or more persons to carry on a business for profit as owners . . . , whether the persons intend to create a partnership and whether the association is called a 'partnership,' '*joint venture*,' or other name." TEX. REV. CIV. STAT. ANN. art. 6132b-3.04, § 2.02(a) (Vernon 2001) (emphasis added). The 1993 Bar Committee comment states: "The subsection also explicitly includes a joint venture that satisfies the definition of 'partnership' as a partnership subject to TRPA. This codifies existing case law." TEX. REV. CIV. STAT. ANN. art. 6132b-3.04, § 2.02(a) cmt. (Vernon Supp. 2001). Somehow, retaining the peculiar Texas common law requirement that "loss-sharing" be found seems to fly in the face of this.

32. Act of Sept. 1, 2001, 77th Leg., R.S., ch. 757, 2001 Gen. Sess. Laws 1481.

33. TEX. REV. CIV. STAT. ANN. art. 6132a-1, § 1.06(i) (Vernon Supp. 2001).

34. TEX. REV. CIV. STAT. ANN. art. 6132a-1, § 6.01(b)(11) (Vernon Supp. 2001).

ful withdrawal.[35] These changes are intended to protect a partner from an involuntary change in status, for example, to a corporate shareholder, which could have adverse tax or other consequences.

B. Limited Liability Companies.

One notable change to the Texas Limited Liability Company Act[36] was made, requiring that limited liability companies that are dissolving, or foreign limited liability companies that are withdrawing from conducting business in Texas, provide to the secretary of state a certificate from the comptroller of public accounts that all taxes, not just franchise taxes (which was the requirement before amendment), including all penalties and interest, that are administered by the comptroller under Title 2, Tax Code, have been paid.[37]

35. Tex. Rev. Civ. Stat. Ann. art. 6132a-1, § 6.01(c) (Vernon Supp. 2001). Presumably, these results may be varied by agreement of the partners, under the authority of TRPA Section 1.03(a), with the possible limitation that the conversion action and result provided for under the partnership agreement is found not to have violated the obligation of good faith under TRPA Section 4.04(d), which under Section 1.03(b), cannot be eliminated, although it may be defined.

36. Tex. Rev. Civ. Stat. Ann. art. 1528n (Vernon Supp. 2001).

37. The amendment relating to dissolution is to Article 6.08 and to withdrawal is to Article 7.10.