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Partnerships

Steven A. Waters

Jeremy Adam Kruger

PARTNERSHIPS

*Steven A. Waters**
*Jeremy Adam Kruger***

I. INTRODUCTION

THIS Survey period did not produce a bumper crop of partnership and limited liability company cases. None of those reported on could be considered significant for its partnership law issues; but, as usual, there is some learning or affirmation. The Survey period did include a legislative session, where some potentially significant changes were wrought.

II. PARTNERSHIP CASES

A. PARTNERSHIP AUTHORITY AND LIABILITY—*LONG V. LOPEZ*

This case reaffirms basic principles of a general partner's authority and its joint and several liability for partnership obligations.[1] Long, Lopez and Bannister formed an oral partnership and began doing business under the filed assumed name "Woods Relo, a General Partnership." Like most businesses, Woods Relo needed some basic office equipment, which Long secured for the partnership by arranging a 30-month office equipment lease for telephones, photocopier and fax machine. As the only person around when the equipment vendor delivered and installed the equipment, Long signed the lease for the partnership and also signed individually as personal guarantor.[2]

Things did not work out for Woods Relo. It lost a major client, its business declined and it could not pay its obligations, including the equipment lease. The vendor repossessed the equipment and, after its collection efforts failed, filed a lawsuit naming the partnership and Long, individually (as guarantor). Long negotiated a settlement for the partnership and for himself, paid the settled debt and then sought contribution from the other two partners. Lopez refused to pay and Bannister was in bankruptcy, so Long filed suit against Lopez. The trial court found that settling the debt and resolving the lawsuit were beyond Long's actual and

* B.A., Southern Methodist University; J.D., University of Texas. Attorney at Law, Haynes and Boone, L.L.P., San Antonio, Texas.
** B.S., The United States Air Force Academy; J.D., University of Texas. Attorney at Law, Haynes and Boone, L.L.P., San Antonio, Texas.

1. Long v. Lopez, 115 S.W.3d 221 (Tex. App.—Fort Worth 2003, no pet.).
2. *Id.* at 223-24. Long's signing as guarantor was a surprise condition to the vendor's leaving the equipment. *Id.*

apparent authority because he did not involve Lopez, so it issued a take nothing judgment.[3] The court of appeals reversed and *rendered* the judgment of the trial court and then issued a lesson in basic partnership principles. First, because Woods Relo did not have a partnership agreement, the "default" or fallback rules under the Texas Revised Partnership Act (TRPA) became applicable to the partnership.[4] The court identified several of those governing default provisions: Partners have equal rights in management, partners are jointly and severally liable for partnership debts, an act is within a partner's apparent authority if it is apparently carried on in the ordinary course of the partnership business. Also, because Long settled the lawsuit as part of winding up the partnership's business, the court discussed a partner's responsibilities during that phase of a partnership's life, which include a duty to exercise the standard of care of "an ordinarily prudent person" and a limitation on the scope of a partner's authority to matters that relate to winding up.[5]

Lopez argued that he could not be held liable to the equipment vendor because he was not a party to the lawsuit that Long settled. The court disagreed with Lopez's argument that he was an indispensable party to that lawsuit[6] and found more than enough case law for the proposition that "it is not necessary to serve all the partners to support a judgment against the partnership."[7] Also, Long was not a third-party creditor seeking to pursue a partner regarding a partnership debt;[8] rather, he was a partner who had paid more than his share of a partnership obligation, and sought contribution from another partner. That is his right.[9]

A creditor's obtaining a guaranty from a partner (as the equipment vendor did here) often is considered an unnecessary "belts and suspenders" contractual addition to the partners' statutory liability for partnership obligations. There is value, however, in being able to directly pursue a guarantor as an independent obligor (instead of via the derivative liability of a partner for a partnership's obligations). Under the TRPA, a creditor can pursue a partner directly without also pursuing the partnership only in certain circumstances.[10] If those circumstances are not present, then having the guaranty, and with it the ability to pursue the guarantor/

3. *Id.* at 225.

4. *Id.* Partnerships can be created orally or by written agreement. If created orally (and there often is an issue about whether any was created in the first place if there is no evidence in the form of a written agreement), there is still the issue of defining the partners' oral agreement—they could have, for example, agreed that distributions were to go first to one partner until the occurrence of a future event, or that one partner had certain rights in management that the others did not have, etc. Here, apparently, there was nothing more than mere agreement to be partners, so the statute fills in the gaps.

5. *Id.* at 226.

6. *Id.* at 227. The court dismissed the suggestion that TEX. R. CIV. P. 39(a) applied.

7. *Id.*

8. *See* TEX. REV. CIV. STAT. ANN. art. 6132b, 1.01 et seq. ("TRPA") § 3.05 [hereinafter TRPA].

9. TRPA §§ 4.01(c), 4.06(b), which the court discussed. *See Long*, 115 S.W.3d at 228.

10. *See* TRPA § 3.05. Except in the limited circumstances spelled out in TRPA Section 3.05(d), a partner cannot be pursued as freely as a guarantor can.

partner directly, is valuable. In either situation, if a creditor elects to pursue fewer than all of the obligated parties (e.g. one general partner, or a guarantor and not the principal), and if that unlucky party is called on to pay more than "its share" of the obligation, then the paying party has the right to seek contribution from the other obligated parties, which is what Long was seeking in his suit against Lopez.[11]

B. CONTRACTUAL JURY WAIVERS—*IN RE* WELLS FARGO BANK MINNESOTA N.A.

One might fairly ask what a contractual jury waiver discussion is doing in a place like a partnership law survey. The answer is simple—the important issue on contractual jury waivers arose in a partnership context. The subject matter, parties and applicable law all also straddle the Sabine River, adding another dimension.[12]

The procedural setting in this case was a petition for writ of mandamus where Wells Fargo, as plaintiff, was seeking to enforce a contractual jury waiver contained in its loan documents. The court described the case as one of first impression in Texas.[13]

The borrower was a Louisiana "*partnership in commendam*" (think, limited partnership), with a Texas corporation as its general partner. Both the mortgage note and a guaranty contained conspicuous jury waivers and Louisiana choice of law provisions.[14]

When the bank sued to enforce its loan documents, the borrower and guarantor made jury demands that the trial court granted over the bank's effort to enforce the contractual jury waivers. In response to the petition for writ of mandamus,[15] which was conditionally granted,[16] the court drew a parallel between a contractual jury waiver and an arbitration agreement, noting that the latter essentially has the same effect as a jury waiver but results in a waiver of even more rights.[17] Finding support in two places—a strong policy favoring arbitration agreements and Texas' policy favoring freedom of contract—the court reasoned that, *a fortiori*, a party should be permitted to waive the lesser included right to have a jury trial.[18]

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11. Regarding the partnership context, see *supra* note 9.

12. *In re* Wells Fargo Bank Minn. N.A., 115 S.W.3d 600 (Tex. App.—Houston [14th Dist.] 2003, app. for mand. filed (Sept. 19, 2003)).

13. *Id.* at 605. The reader can judge whether that justifies inclusion here.

14. *Id.* at 603-04; interestingly, there was no choice of forum provision.

15. *Id.* The court explained that the equitable remedy of mandamus is available to correct an arbitrary and unreasonable decision of the trial court where there is no other adequate remedy at law. If the matter involves a factual determination, then the standard is whether there is only one reasonable determination for the court to make; if the matter involves a legal issue, then to grant the writ requires a showing that the trial court failed to correctly evaluate or apply the law. *Id.*

16. *Id.* at 612. The condition was that the trial court failed to vacate its decision by a certain date. *Id.*

17. *Id.* at 607.

18. *Id.* There is some logic in that, but one could argue that a stated Constitutional right has independent status.

So, where is the partnership issue? As noted, there is not much of one, but the case was too important not to cover. The partnership issue was whether the partnership borrower, acting through its general partner, had authority to bind the general partner with the partnership's waiver of the right to have a jury trial. Although it was not the only interested party arguing that the jury trial waiver should not be enforced against it (and they all argued that it was unconstitutional), the general partner of the borrower seemed to be asserting that, as to himself, the waiver that applied to the partnership—as the only signatory to the mortgage note—was not binding on the general partner itself.[19]

Although it might have responded more directly, the court chose to base its decision on a contract interpretation that the waiver in the mortgage note was given by the "Maker," which the note defined to include its "legal representatives." The court found that this necessarily included the general partner as the partnership's legal representative. It further based its decision on the general partner's joint and several liability for the partnership's obligations under Louisiana law, which under the terms of the mortgage note made it "jointly and severally bound by [the partnership's] obligations under the note, including the jury waivers."[20]

C. PARTNERSHIP INTERESTS AND PARTNERSHIP PROPERTY—*UNITED AMERICAN INSURANCE CO. V. STRAYHORN*[21]

It is black letter partnership law that a partner owns an interest in personal property—the partnership interest—regardless of the nature of the partnership's assets, and does not own the partnership's assets.[22] Insurance companies doing business in Texas are subject to a premium tax that can be reduced to the extent the company invests its assets in certain ways, including in "real property or any interest therein."[23] Here, United American Insurance Company acquired limited partners' interests in limited partnerships that invested in mineral interests (real property under Texas law). Finding tax deductions to be a matter of legislative discretion to be strictly construed, the court dismissed United American's argument that "any interest therein" supported its claim that, for purposes of the premium tax, it effectively had invested in real property.[24] The court held that, as a matter of law, the owner of a limited partnership interest that owns mineral interests is not an investor in real property.[25]

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19. *Id.* at 609. Apparently, the general partner's argument was that it had signed the mortgage note only to bind the partnership and not for itself, separately. *Id.*

20. *Id.*

21. United Am. Ins. Co. v. Strayhorn, 108 S.W.3d 448 (Tex. App.—Austin 2003, no pet.).

22. TRPA § 5.02. *See also*, "Partnership property is not property of the partners." (citing Humphrey v. Bullock, 666 S.W.2d 586, 590 (Tex. App.—Austin 1984, writ ref'd n.r.e.)).

23. *Strayhorn*, 108 S.W. 3d at 450; TEX. INS. CODE ANN. art. 4.11 § 2(b) (2004).

24. *Id.* at 451-52. The court agreed that interests in real property meant "leaseholds, licenses, and mineral estates." *Id.* at 452.

25. *Id.* at 454.

III. LEGISLATION

The Survey period included a legislative session. House Bill 1637 amends several provisions of the Texas Limited Liability Company Act ("TLLCA"), the Texas Revised Limited Partnership Act ("TRLPA"), and the Texas Revised Partnership Act, effective September 1, 2003.

A. TEXAS LIMITED LIABILITY COMPANY ACT

This bill amended Article 2.23 of the Texas Limited Liability Company Act[26] to add a new Section C-1, providing that members or managers may take action at a meeting or without a meeting, in any manner permitted by the constituent documents of the limited liability company (LLC), or by the TLLCA. Also, unless the Articles of Organization or the regulations otherwise provide, an action is effective if taken by the affirmative vote of the persons who have the voting strength necessary to take the action at a meeting at which all members or managers, as appropriate, entitled to vote on the action were present and voted, or if the action is taken by consent of each member of the LLC, which may be established by the member's failure to object in a timely manner if the member has full knowledge of the action, or by a written consent, or by any other reasonable means.

Article 4.01 was amended to provide that, after formation, a limited liability company can admit a new member who is not an assignee of a membership interest without that member acquiring a membership interest. Furthermore, with this amendment, the LLC's regulations now may provide for the admission of a person as a member and the issuance of a membership interest to the person without the person's either making a contribution to the limited liability company or assuming an obligation to make such a contribution.[27]

Article 5.02-1 was amended to bring the TLLCA in line with the Texas Revised Limited Partnership Act.[28] The article says that, if the LLC's regulations do not otherwise provide, profits and losses shall be allocated on the basis of the agreed value of the contributions made by each member as stated in the LLC's records.

Article 6.01 was amended to eliminate the "default" rule that, unless the regulations otherwise provided, dissolution of the LLC occurs on the death, expulsion, withdrawal, bankruptcy or dissolution of a member.

Article 6.06 was amended to provide that a voluntary dissolution can be retroactively revoked by a filing made up to 120 days after the issuance by the Secretary of State of a Certificate of Dissolution.

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26. TEX. REV. CIV. STAT. ANN. art. 1528n (2003) [hereinafter TLLCA].

27. TLLCA § 4.01. *See* footnote for a brief explanation of the rationale for this change.

28. TEX. REV. CIV. STAT. ANN. art 6132a-1 (2003) [hereinafter TRLPA].

B. Texas Revised Limited Partnership Act

House Bill 1637 amended TRLPA Section 1.02(12) to expand the definition of "person" to expressly include various entities, including business trusts, registered limited liability partnerships and limited liability companies.[29]

Section 4.01 was amended to enable partners to include in a written partnership agreement[30] a provision that allows a person to be admitted as a general partner in a limited partnership, including as the sole general partner, and to acquire a partnership interest in that limited partnership, without either making a contribution or assuming an obligation to make a contribution. Also, a written partnership agreement may allow a person to be admitted as a general partner, including as the sole general partner, without acquiring a partnership interest in the partnership.[31]

C. Texas Revised Partnership Act

House Bill 1637 modified Subsection (5) of Section 6.01(b), which deals with events of withdrawal of a partner, to provide that withdrawal from the partnership occurs on a partner's expulsion by entry of a judicial decree finding that the partner engaged in wrongful conduct, "willfully or persistently committed a material breach of the partnership agreement or of a duty owed to the partnership or the other partners," or "that the partner engaged in conduct relating to the partnership business that made it not reasonably practicable to carry on the business in partnership with that partner."[32] This change corrects a glitch that had provided that withdrawal occurred on mere *application* made by the partnership or any partner, before any judicial decree was issued.

D. Government Code

Importantly, Section 405.020 of the Government Code entitled "PUBLIC RECORDS" was amended to require that the "secretary of state permanently maintain as a public record any instrument, or the information included in any instrument, that is filed with the secretary of state to evidence the organization of, or otherwise in connection with, any entity

29. TRLPA § 1.02(12). Also included was a catch all of "any other legal or commercial entity in its own or a representative capacity, regardless of whether the entity is formed under the laws of this state or any other jurisdiction." *Id.*

30. TRLPA Section 1.02(10) provides that a "partnership agreement" is any written or oral agreement of the partners that deals with the affairs of a limited partnership and the conduct of its business. There are, however, many places in the TRLPA where a *written* agreement is required on specified issues for these issues to apply to the particular partnership.

31. These are functionally the same provisions as those added to TLLCA Section 4.01. Their purpose is to give the same flexibility in structuring a Texas partnership as now exists in Delaware; in both cases, the changes respond to capital market forces that desire to give "partner" rights (such as voting on whether to file bankruptcy) to interested outside parties who are not investors.

32. TRPA § 6.01(h)(5).

formed under" Texas law.[33] This provision was important because of the defined term "registered organization" used in Chapter 9 of the Uniform Commercial Code adopted in Texas, which determines the office in which financing statements must be filed to perfect a security interest for entities formed by filing an organizational document.

33. TEX. GOV. CODE ANN. § 405.020 (Vernon 2003).