Partnership Law

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I. INTRODUCTION

During the Survey period, Texas courts continued to grapple with a number of key partnership and limited liability company issues, in some cases providing a clearer path on previously unclear matters and in other cases merely adding to a body of seemingly inconsistent authorities. The cases below highlight controversies concerning fiduciary duties, veil piercing, the legal effect of a conversion from a corporation to a limited liability company (LLC) and arbitration provisions in LLC agreements, among other issues.

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II. FIDUCIARY DUTIES

A. *In re Hardee*

In *ETRG Investments, LLC v. Hardee*, the U.S. Bankruptcy Court for the Eastern District of Texas provided guidance on the fiduciary duties that a managing member owes to its LLC and its members.1

In May 2005, James Hardee, Dan Tomlin, and Mark Scott formed ETRG Investments, L.L.C. (ETRG) as a Texas limited liability company.2 Tomlin and Scott provided all of the equity for ETRG, and Hardee managed its operations as the managing member.3 ETRG was obligated to pay Hardee an annual salary of approximately $75,000 in exchange for being the managing member.4

During his tenure as a managing member of ETRG, Hardee used company funds to pay personal expenses, to pay excessive expense reimbursements, and to receive compensation in excess of the amount he was authorized to receive.5 To conceal this embezzlement, Hardee fabricated financial statements, which he delivered to the members of ETRG.6 In addition, as ETRG’s tax matters member, Hardee failed to tender a required tax payment to the IRS on behalf of ETRG.7 Lastly, Hardee unilaterally procured a $350,000 SBA loan despite the LLC agreement’s requirement that he obtain unanimous consent from ETRG’s members prior to incurring any indebtedness of $100,000 or more on behalf of the company.8

In December 2010, ETRG and Tomlin instituted separate lawsuits against Hardee in a county court.9 Hardee later filed bankruptcy and sought to discharge his obligations to ETRG, Tomlin, and Scott.10 As a result of the bankruptcy, the county court suits were stayed.11

ETRG, Tomlin, and Scott then sought a determination that Hardee’s debts to them were nondischargeable because they were either (1) debts obtained by false representation, false pretenses, or actual fraud; or (2) “debt[s] arising from a defalcation by a fiduciary and/or embezzlement.”12 In its opinion, the court bifurcated the analysis of ETRG’s claims from the claims of Tomlin and Scott.13

In reviewing ETRG’s claims against Hardee, the trial court determined that

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2. Id. at *1. The company was formed for the purpose of owning and operating a fast-food restaurant in Arkansas. Id.
3. Id.
4. Id.
5. Id.
6. See id.
7. Id. at *3.
8. Id. at *1–2.
9. Id. at *2.
10. Id.
11. Id.
12. Id.
13. See id. at *3–5. In October 2011, in a separate case before the United States District Court of the Eastern District of Texas, Hardee was charged with and pled guilty to the federal crime of wire fraud. Id. at *1.
Hardee breached his fiduciary duties to ETRG.\textsuperscript{14} Although the Texas Business Organizations Code (TBOC) does not directly address or define the duties owed by managers and members of an LLC, it implies that certain duties may be owed.\textsuperscript{15} The court then analyzed the fiduciary relationship that arises as a matter of Texas law between a principal and agent.\textsuperscript{16} An agent is authorized by a person or entity to transact business on behalf of such person or entity.\textsuperscript{17} The court went on to analyze the fiduciary relationship between corporate officers and the corporations that they serve.\textsuperscript{18} The court then found that while limited liability companies are not corporations, Texas law implies that the fiduciary status of corporate officers and directors and the duties of due care, loyalty, and obedience apply to managers and members governing an LLC.\textsuperscript{19}

As a result, the court found that Hardee was the sole person authorized to transact business and direct financial activities of ETRG and, thus, acted as its agent and owed ETRG fiduciary duties.\textsuperscript{20} Hardee’s embezzlement scheme, his unauthorized lending relationship, and his failure to pay ETRG’s taxes to the IRS constituted a defalcation while acting in a fiduciary capacity, and thus, these acts were willful breaches of his fiduciary duties.\textsuperscript{21} Further, the court found that Hardee also violated the LLC agreement by (1) failing to pay required taxes to the IRS, a duty mandated by the LLC agreement, which designated him as the “tax matters member”; and (2) incurring indebtedness on behalf of the LLC without obtaining the required consents pursuant to the LLC agreement.\textsuperscript{22}

In reviewing the individual plaintiffs’ claims, the court found that Tomlin and Scott failed to establish that Hardee owed them any fiduciary duties or that their initial investments were procured by actual fraud or misrepresentation.\textsuperscript{23} The court stated that Texas case law has recognized that there is no formal fiduciary relationship created as a matter of law between members of an LLC.\textsuperscript{24} While the TBOC allows LLC members to impose fiduciary duties on themselves in their LLC agreements, the LLC agreement of ETRG neither imposed nor even addressed the existence of fiduciary duties by and among its members.\textsuperscript{25}

\textsuperscript{14.} Id. at *3.
\textsuperscript{15.} Id. at *7–8 (citing TEX. BUS. ORGS. CODE ANN. § 101.401 (West 2012)). TBOC “allows the contracting parties to specify the breadth of [fiduciary] duties” that a member, manager, officer, or other person has to the LLC or to a member or manager of an LLC in the LLC agreement. Id. at *8.
\textsuperscript{16.} Id.
\textsuperscript{17.} Id. “The critical element of an agency relationship is the right [for the principal] to control . . . both the means and the details of the process by which the agent is to accomplish his task . . . .” Id.
\textsuperscript{18.} Id.
\textsuperscript{19.} Id. at *9.
\textsuperscript{20.} Id. at *3, *9.
\textsuperscript{21.} Id. The court found that “defalcation is a willful neglect of duty . . . and is essentially a reckless standard.” Id. at *9 (internal quotations omitted).
\textsuperscript{22.} Id. at *2–3, *10.
\textsuperscript{23.} Id. at *4–5.
\textsuperscript{24.} Id. at *10. “It is widely recognized that ‘there is no formal fiduciary relationship created as a matter of Texas law between members of a limited liability company.’” Id. (citing Fed. Ins. Co. v. Rodman, LLC, No. 3:10-CV-2042-B, 2011 WL 5921529, at *3 (N.D. Tex. Nov. 28, 2011); Entm’t Merch. Tech., LLC v. Houchin, 720 F. Supp. 2d 792, 797 (N.D. Tex. 2010)).
\textsuperscript{25.} Id. at *4, *8.
Hence, Hardee did not owe a formal fiduciary duty to Tomlin and Scott.\textsuperscript{26} The court further reasoned that Tomlin and Scott failed to prove even the existence of an informal fiduciary or trust relationship between them.\textsuperscript{27} The court defined this relationship as a “confidential relationship” arising from “moral, social, domestic, or personal relationships in which one person trusts in and relies on another.”\textsuperscript{28} A fiduciary duty arises when a person is required to place another’s interest above her own—this duty is not created lightly.\textsuperscript{29} The court concluded that Hardee had no formal fiduciary or trust relationship with the members of ETRG.\textsuperscript{30}

Lastly, the court analyzed Tomlin and Scott’s claim that Hardee’s debts to them were nondischargeable because their initial investments were procured by actual fraud or misrepresentation.\textsuperscript{31} The court stated the individual plaintiffs could prove this by demonstrating that either (1) Hardee made representations to them at the time of their initial investment that Hardee knew were false at the time of the solicitation or (2) Hardee made false representations to them at the time of their initial investment with the intention and purpose of deceiving them.\textsuperscript{32} The court, however, found that the individual plaintiffs failed to demonstrate the evidence required to prove their claims.\textsuperscript{33} The court found that the best evidence indicates that Hardee devised his embezzlement scheme after soliciting the initial investment for ETRG.\textsuperscript{34}

This case demonstrates that unless specified expressly in the LLC agreement, LLC members do not owe fiduciary duties to each other.\textsuperscript{35} The managers or managing members of an LLC, however, do owe fiduciary duties to the LLC.\textsuperscript{36}

B. TEXAS STANDARD OIL & GAS V. FRANKEL

In \textit{Texas Standard Oil & Gas, L.P. v. Frankel Offshore Energy, Inc.}, the Houston Court of Appeals, Fourteenth District, explored the issue of the fiduciary duties members owe each other when they become adverse litigants.\textsuperscript{37} In July 2006, Frankel Offshore Energy, Inc. (Frankel) and three other entities\textsuperscript{38} (collectively GTP) formed FGP, LLC (FGP) as a Delaware limited liability company to develop oil and gas prospects.\textsuperscript{39} Frankel was the managing member of FGP and

\begin{itemize}
    \item \textsuperscript{26} Id. at *4.
    \item \textsuperscript{27} Id. at *11.
    \item \textsuperscript{28} Id. at *10 (internal quotations omitted) (stating that such a relationship “exists where a special confidence is placed in another who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one placing confidence”).
    \item \textsuperscript{29} Id.
    \item \textsuperscript{30} Id. at *11.
    \item \textsuperscript{31} Id.
    \item \textsuperscript{32} Id. at *5.
    \item \textsuperscript{33} Id.
    \item \textsuperscript{34} Id.
    \item \textsuperscript{35} Id. at *7–8, *10.
    \item \textsuperscript{36} Id. at *9.
    \item \textsuperscript{37} Tex. Standard Oil & Gas, L.P. v. Frankel Offshore Energy, Inc., 394 S.W.3d 753 (Tex. App.—Houston [14th Dist.] 2012, no pet.).
    \item \textsuperscript{38} The names of these entities were Grimes Energy Co., Texas Standard Oil & Gas, L.P., and PetroVal, Inc. Id. at 756.
    \item \textsuperscript{39} Id. at 757.
\end{itemize}
owned a 50% membership interest.40

Frankel, GTP, and FGP entered into a “Participation Agreement” that
required each party to immediately notify the other parties of any oil and gas
prospects.41 “The Participation Agreement also contained mutual non-compete
covenants,” which would remain in effect until “two years after all parties’
interest in a prospect had terminated.”42 Further, two of the members of GTP
were required to use their “best efforts” to market any oil and gas prospects.43
Lastly, the Participation Agreement required all members to pay “cash calls,”
and it provided that if a member failed to timely pay three cash calls, the
member would forfeit all rights to participate in the prospect for which the cash
calls were required.44

In October 2007, GTP notified Frankel that it was in default for failure to
pay multiple cash calls.45 Without informing Frankel, GTP found a
replacement—Scott Broussard—and created another entity with him called
Trifecta Oil & Gas, LLC (Trifecta).46 In December 2007, a third party filed an
involuntary bankruptcy proceeding against Frankel, and GTP intervened as a
creditor of Frankel.47 Frankel contended that GTP breached the Participation
Agreement and that Frankel should be compensated for several prospects.48 In
March 2008, GTP and Frankel entered into a settlement agreement that
terminated their relationship, except for holding existing seismic licenses.49 “The
Settlement Agreement contained broad mutual release provisions” regarding
several claims, including fraudulent-inducement claims.50

While GTP was negotiating the settlement agreement with Frankel, GTP was
simultaneously negotiating the sale of certain oil and gas prospects from Trifecta
to an entity of which Broussard was president and CEO.51 GTP did not disclose
the potential sale to Frankel because it was concerned Frankel would not sign
the settlement agreement if Frankel knew about the Trifecta sale.52 The Trifecta
sale took place “two months after execution of the Settlement Agreement,
[where] Trifecta sold six prospects . . . in a multi-million dollar transaction.”53

When Frankel found out about the Trifecta sale, it sued GTP, alleging a
breach of fiduciary duty, among other claims, and sought to rescind the
settlement agreement and recover lost profits due to Frankel’s exclusion from

40. Id. GTP collectively owned the remaining 50% membership interest. Id.
41. Id.
42. Id.
43. Id.
44. Id.
45. Id. at 758.
46. Id. Scott Broussard invested in Trifecta through his entity Cutter Energy. Id.
47. Id. GTP claimed that Frankel “was liable for various seismic charges . . . and defaulted on
cash calls.” Id.
48. Id.
49. Id. The agreement was called “Settlement Agreement and Release of All Claims” and
required GTP to pay Frankel $135,000 in exchange for Frankel relinquishing its interest in FGP
prospects. Id.
50. Id.
51. Id.
52. Id.
53. Id. at 759.
Frankel argued that the Trifecta sale involved prospects that were acquired by or should have been pursued on behalf of FGP. GTP argued that Frankel released all its claims under the settlement agreement and that by filing suit, it breached that agreement.

The trial court held that GTP was a fiduciary and breached its duties by fraudulently inducing Frankel into signing the settlement agreement. In the court’s view, the fraudulent-inducement release in the settlement agreement was unenforceable because the parties were fiduciaries and the settlement agreement was not an arm’s-length transaction. The court opined that “a fraudulent-inducement release is enforceable [between fiduciaries] only if they first contractually disavow their respective fiduciary duties.” Finding no evidence that the parties contractually disavowed their fiduciary duties, the trial court ordered rescission of settlement agreement.

The court of appeals rejected the trial court’s holding and found that the fraudulent-inducement release was enforceable. The appellate court contended that there is no requirement for the parties to first disavow their fiduciary duties before they sign an enforceable release. The appellate court first analyzed the settlement agreement itself and held that the agreement met the “clear and unequivocal intent” standard, contained no misrepresentation, and met the Forest Oil factors—(1) the parties specifically discussed the issue that has become the topic of the dispute; (2) Frankel was represented by his own counsel; (3) the settlement agreement was freely negotiated; (4) Frankel was sophisticated about business matters; and (5) the fraudulent-inducement release was clear and unequivocal.

The court of appeals next analyzed whether the parties were fiduciaries and considered the practicality of release provisions. The court reasoned that litigants cannot be saddled with all the fiduciary duties that generally accompany a fiduciary relationship. The court also noted that “when the Settlement Agreement was executed, Frankel did not believe that the existence of any fiduciary relationship vitiated a fraudulent-inducement release.” The court reasoned that even fiduciaries have the right to ensure finality to their disputes,

54. Id.
55. Id.
56. Id.
57. Id. at 760. The trial court had instructed the jury that GTP owed Frankel a fiduciary duty and the jury found that although GTP breached its fiduciary duties, Frankel had “unclean hands.” Id. Further, the jury declined to assess any damages for breach of fiduciary duty, leaving Frankel to rely on his claim to rescind the settlement agreement. Id.
58. Id.
59. Id.
60. Id.
61. Id. at 762.
62. Id. at 777.
63. Id. at 762–77 (citing Forest Oil Corp. v. McAllen, 268 S.W.3d 51, 60 (Tex. 2008) (a seminal case on the enforceability of a disclaimer of reliance or other provision in a settlement agreement waiving a fraudulent-inducement claim)).
64. Id. at 776–77.
65. Id. at 777 n.15.
66. Id. at 777.
and as such, when they execute clear and unequivocal agreements like the one in this case, their express intent should be accorded the same respect as that of other contracting parties. Accordingly, the court of appeals reversed the trial court's decision rescinding the settlement agreement.

Texas Standard Oil & Gas serves as a helpful primer regarding the fiduciary duties LLC members owe each other when they become adverse litigants. The court highlighted the Forest Oil factors as the guiding factors to consider when determining enforceability of a disclaimer of reliance. This case illustrates the amount of deference Texas courts provide to clear and unequivocal agreements.

III. VEIL PIERCING

A. K-Solv v. McDonald

In K-Solv, LP v. McDonald, the Houston Court of Appeals, First District, explored the issue of common-law veil piercing in the context of an LLC and its members. Energy America Geothermal, LLC (Energy America) received but failed to pay for materials from K-Solv, LP (K-Solv). Subsequently, K-Solv filed suit against Energy America for a breach of contract, quantum meruit, suit on sworn account, and fraud. Later, K-Solv amended its petition to join Edward McDonald and Alan Peters, the individual members of Energy America. The amended petition sought to impose vicarious liability on McDonald and Peters for the obligations of Energy America. The individual members filed a motion for summary judgment, and the trial court granted the motion dismissing them from the case.

K-Solv appealed the dismissal of its vicarious liability claim against McDonald and Peters, arguing that McDonald and Peters were personally liable for the obligations of Energy America under common-law veil-piercing theories. The appellate court first analyzed the TBOC, which provides that an LLC member “is not liable for a debt, obligation, or liability of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or order of a court.” The LLC members, however, are free to modify this provision by

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67. Id. (stating that Frankel understood that GTP was protecting its own interests by negotiating inclusion of fraudulent-inducement release, and thus, could not reasonably rely on GTP to protect Frankel's interests relative to this provision).
68. Id.
69. Id. at 762–78.
70. K-Solv, LP v. McDonald, No. 01-11-00341-CV, 2013 WL 1928798, at *1 (Tex. App.—Houston [1st Dist.] May 9, 2013, no pet.).
71. Id.
72. Id.
73. Id. After Energy America's motion for summary judgment was granted, "K-Solv . . . nonsuited its breach of contract and quantum meruit claims against Energy America, and voluntarily dismissed all claims against all of the individual defendants other than McDonald and Peters." Id.
74. Id.
75. Id.
76. Id. at *1–2.
77. Id. at *2 (citing TEX. BUS. ORGS. CODE ANN. § 101.114 (West 2012)).
specifically stating their intentions in their LLC agreement.\textsuperscript{78} Hence, McDonald and Peters argued that, by default, the TBOC bars vicarious liability against LLC members.\textsuperscript{79}

The court of appeals analyzed the elements of common-law veil-piercing in the LLC context.\textsuperscript{80} The elements of common-law veil-piercing are (1) the suit is based on or relates to a contract; (2) the defendant perpetrated an actual fraud on the plaintiff; and (3) the defendant perpetrated such fraud primarily for the defendant’s direct personal benefit.\textsuperscript{81} Because K-Solv’s claims arose out of its purchase agreement with Energy America, the first element was met.\textsuperscript{82} As a result, the court noted that vicarious liability for the individual defendants was contingent on a showing of actual fraud and a direct personal benefit.\textsuperscript{83}

McDonald and Peters asserted that the direct personal benefit must be something more than drawing a salary from the company.\textsuperscript{84} K-Solv, on the other hand, argued that McDonald and Peters derived a direct personal benefit because they were able to divert the money Energy America would have otherwise paid to K-Solv toward loan obligations that McDonald and Peters personally guaranteed and IRS 941 taxes, “which if not paid would have resulted in a 100% personal penalty on McDonald and Peters.”\textsuperscript{85}

The court of appeals rejected K-Solv’s arguments and held that even if the payment of Energy America’s debt and tax obligations constituted the type of “direct personal benefit” necessary to find Energy America’s members vicariously liable for its contractual obligations, the bank statements submitted by K-Solv failed to establish any connection between Energy America’s transaction with K-Solv and its loan and tax payments.\textsuperscript{86} Hence, the court of appeals affirmed the trial court’s grant of summary judgment and ruled in favor of the individual defendants.\textsuperscript{87}

This decision highlights that the standard for piercing the veil of an LLC is likely as daunting of a challenge as is the standard for piercing the veil of a limited partnership.\textsuperscript{88}

\textsuperscript{78} Id.
\textsuperscript{79} Id.
\textsuperscript{80} Id. at *2–4. K-Solv argued that “despite these statutory provisions [barring vicarious liability in the LLC context], Texas courts have nevertheless applied common-law veil-piercing theories in the LLC context.” Id. at *2. Without ruling on K-Solv’s argument, the court began analyzing common-law veil-piercing in this particular case. Id.
\textsuperscript{81} Id.
\textsuperscript{82} Id.
\textsuperscript{83} Id.
\textsuperscript{84} Id. at *3 (stating that “direct personal benefit” must be something more than a salary draw or other expenses from the company [and] any personal benefit must be direct”).
\textsuperscript{85} Id.
\textsuperscript{86} Id.
\textsuperscript{87} Id.
IV. EFFECT OF CONVERSION

A. GUNDA CORP. V. YAZHARI

In Gunda Corp. v. Yazhari, the Houston Court of Appeals, Fourteenth District, examined the effects of the conversion of an entity into a new organizational form.\(^{89}\) In 2007, Ramesh Gunda recruited David Yazhari to work for his company Gunda Corporation, Inc. (GC INC).\(^{90}\) In 2008, GC INC gave its employees a policies and procedures manual, and had them sign an acknowledgement that they had read and understood its terms and conditions.\(^{91}\) Contemporaneously, each employee was asked to read and sign various other documents and agreements, including an arbitration policy and agreement.\(^{92}\) The arbitration agreement required disputes between GC INC and the employee related to the employee’s employment with GC INC to be resolved by arbitration.\(^{93}\) In 2010, GC INC converted into a limited liability company named Gunda Corporation, LLC (GC LLC).\(^{94}\) A few months later, GC LLC terminated Yazhari’s employment.\(^{95}\)

Thereafter, Yazhari filed suit against GC LLC, alleging many claims related to his termination.\(^{96}\) In response, GC LLC moved to compel arbitration in accordance with the arbitration agreement.\(^{97}\) Yazhari then asserted, among other arguments, that the arbitration agreement between GC INC and Yazhari did not govern a dispute between GC LLC and Yazhari because GC LLC and GC INC are different entities.\(^{98}\) The trial court agreed with Yazhari, and GC LLC appealed.\(^{99}\)

Yazhari contended that because GC LLC was not in existence when the arbitration agreement was entered into, it could not have been a party to the arbitration agreement.\(^{100}\) Yazhari also asserted that the arbitration agreement does not apply to GC INC’s successors and assigns because the arbitration agreement did not include a successors and assigns provision.\(^{101}\) Conversely, GC LLC asserted that, as a converted entity, it had a statutory right to enforce the arbitration agreement.\(^{102}\) The court of appeals held for GC LLC, reasoning

\(^{90}\) Id. at *1.
\(^{91}\) Id.
\(^{92}\) Id.
\(^{93}\) Id. The arbitration agreement also provided for it to continue beyond the Employee’s termination. Id.
\(^{94}\) Id. Yazhari, however, did not get any ownership interest in either GC or GC, LLC. Id.
\(^{95}\) Id.
\(^{96}\) Id. Yazhari’s original petition alleged age and disability discrimination and retaliation under the Texas Commission on Human Rights Act; intentional infliction of emotional distress; failure to transfer one-third ownership of GC, LLC; fraudulent inducement; conversion; shareholder oppression; breach of contract; demand for accounting; and declaratory judgment. Id.
\(^{97}\) Id. at *2.
\(^{98}\) Id.
\(^{99}\) Id.
\(^{100}\) Id. at *6.
\(^{101}\) Id.
\(^{102}\) Id.
that under the TBOC, GC INC did not terminate upon its conversion to GC LLC; rather, it continued to exist and inherited the right to enforce the arbitration agreement from the converting entity.

This case is helpful in that it illustrates the concept that a converted entity is not a new entity for most purposes. This issue arises in many other contexts, such as whether a lender’s approval to a conversion is required if the loan documents required lender approval for a transfer or merger of the borrower.

V. TRANSACTIONS BETWEEN A PARTNER AND ITS PARTNERSHIP

A. ELLIOTT V. ROCKWOOD

In Elliott v. Rockwood Village Partners, Ltd., the Austin Court of Appeals addressed a conflict between the terms of a partnership agreement and a promissory note issued by the partnership to a partner. Mickey Elliott was a limited partner in a limited partnership called Rockwood Village Partners, Ltd. (Rockwood). In 2009, pursuant to a promissory note issued by Rockwood to Elliott, Elliott loaned Rockwood $36,000 to pay Rockwood’s 2009 property taxes and other expenses. The promissory note provided for a December 31, 2010, maturity date. Rockwood did not pay Elliott before the note’s maturity date, so in early 2011, Elliott’s attorney sent a demand letter to Rockwood seeking repayment of the loan.

In response, Rockwood stated that it was not obligated to repay Elliott as prescribed under the promissory note because the promissory note violated Rockwood’s limited partnership agreement, which provides that loans from partners are to be repaid quarterly, but only as Rockwood net profits are available to do so in the general partner’s judgment. Relying on this provision, Rockwood contended that the limited partnership agreement

103. Id. The court of appeals analyzed whether the arbitration agreement was valid. Id. at *3. The court listed the elements of a valid arbitration agreement: (1) the offer; (2) the acceptance; (3) the meeting of the minds; (4) the parties’ consent to the terms; and (5) execution and delivery with the intent that it be mutual and binding. Id. Yazhari alleged that he never consented to arbitration and brought the fourth element in dispute. Id. In response, Gunda and GC LLC produced a copy of the arbitration agreement bearing Yazhari’s signature. Id. The court concluded that whether Yazhari consented to the arbitration agreement was a fact issue, which necessitated an evidentiary hearing. Id. at *4, *6. Because the trial court failed to hold an evidentiary hearing to resolve this material issue of fact, the trial court abused its discretion. Id. at *6.

104. Id. (citing TEX. BUS. ORGS. CODE ANN. § 10.106(1) (West 2012)). “[A]ll liabilities and obligations of the converting entity continue to be liabilities and obligations of the converted entity in the new organizational form without impairment or diminution because of the conversion.” Id. (quoting TEX. BUS. ORGS. CODE ANN. § 10.106(3) (West 2012)).

105. Id.

106. Id.


108. Id.

109. Id.

110. Id.

111. Id.

112. Id.
prohibited a promissory note that stated a specific due date. Accordingly, Rockwood informed Elliott that, in the general partner’s judgment, net profits were not sufficient to repay the loan and that Rockwood did not have to repay the amount until net profits were sufficient.

Elliott sued Rockwood, seeking repayment of the loan and asserting breach of contract. Rockwood responded by stating that the promissory note was void because it had a specific maturity date in violation of the limited partnership agreement. Elliott countered by pointing to several other promissory notes from Rockwood to other limited partners stating a specific maturity date. Elliott argued that by executing these other promissory notes, Rockwood had waived any prohibition against a fixed maturity date in the limited partnership agreement.

The trial court held that the promissory note was not due and payable, and that the promissory note must be reformed to prohibit payments until Rockwood has available net profits. The trial court also concluded that Rockwood did not have sufficient net profits to repay the promissory note and that the promissory note is valid and enforceable, but only as reformed.

It appears that Elliott may not have asserted at the trial court what might have been his strongest argument, which is that his promissory note is not inconsistent with the Rockwood partnership agreement. Although the relevant section (Section 7.03) in the Rockwood partnership agreement states that loans from partners to Rockwood must be repaid as “net profits” are available,” it does not expressly prohibit such partner-partnership loans from being repaid sooner than that. Elliott’s failure to make this argument is a key point in the decision of the court of appeals.

At the court of appeals, Elliott asserted that the promissory note’s failure to comply with the limited partnership agreement should be waived because Rockwood had signed similar promissory notes with other partners. The court of appeals rejected Elliott’s position on this issue, reasoning that Section 7.03

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113. Id. For the promissory note to be valid, Rockwood argued, it should have tracked the exact language of the limited partnership agreement, that payment “shall be repaid quarterly, as net profits are available to do so in the judgment of the general partner.” Id.
114. Id. Rockwood took the position that not only was it not obligated to make quarterly payments, it never had to repay Elliott unless net profits were available. Id.
115. Id. at *2. Elliott also argued that Rockwood is “estopped from refusing to repay the promissory note on its stated maturity date.” Id.
116. Id. Rockwood asserted several counterclaims: (1) breach of contract for making and enforcing the promissory note that violated the limited partnership agreement; (2) breach of Elliott’s duty of loyalty for the same conduct; and (3) reformation, asking the court to declare that the promissory note is payable as provided in the limited partnership agreement. Id.
117. Id.
118. Id.
119. Id. at *3.
120. Id. Further, the trial court found that by attempting to enforce the promissory note, Elliott had breached the limited partnership agreement as well as his duty of loyalty to Rockwood. Id. The court of appeals, however, rejected this argument. Id. at *6.
121. See id.
122. Id.
123. Id.
124. Id. at *2.
does not prohibit Rockwood from executing a promissory note that has a fixed maturity date; rather, Section 7.03 merely requires that obligations on such notes be paid no later than when Rockwood net profits are available. The fascinating aspect of the appellate court’s reasoning is that it implies that if Elliott had simply asserted that his promissory note does not violate Section 7.03, then the court would have ruled in his favor on this issue.

Elliott also asserted that the trial court improperly reformed the promissory note by changing its due date to a time when Rockwood has available net profits. In this argument, Elliott did not assert that reformation was inappropriate; rather, Elliott asserted that the reformation should have included earlier required payment dates to match those in other partner-partnership promissory notes into which Rockwood had entered. In those other promissory notes, the due date was accelerated if Rockwood generated available cash from other than net profits (such as a refinancing). The appellate court accepted this argument.

In this case, the court repeatedly implied that Elliott would have won on appeal had he simply asserted that his promissory note did not violate Section 7.03. Thus, the bad result for Elliott in this case could have been avoided if he had done either of the following: (a) insisted on an amendment to Section 7.03 to avoid any potential ambiguity between the promissory note and Section 7.03 or (b) been more broad minded in assessing the intent of Section 7.03 when arguing his position before the court.

VI. ARBITRATION

A. BAUMEISTER V. REAGAN

In Baumeister v. Reagan, the Fort Worth Court of Appeals heard two similar but separate lawsuits, both regarding the applicability of the arbitration provision in a limited partnership agreement. The first suit involved two individuals: Richard Baumeister, a certified public accountant, and James Reagan, an entrepreneur and a client of Baumeister. Baumeister was a limited partner in Allen 75 Partners, LP (Allen 75), an entity that invested in real property. Reagan claimed that Baumeister solicited a $400,000 investment from him to purchase a limited partnership interest in Allen 75. Baumeister, however, failed to disclose to Reagan that Baumeister was himself a limited

125. Id. at *4.
126. See id. at *4, *6.
127. Id. at *5.
128. Id.
129. Id.
130. Id. at *6.
131. See id. at *4, *6.
132. Baumeister v. Reagan, No. 02-12-00276-CV, 02-12-00277-CV, 2013 WL 530976, at *1
133. Id.
134. Id.
135. Id.
partner in the partnership and was going to make a substantial profit from this transaction. As a result, Reagan brought suit against Baumeister and his CPA firm (collectively, the Accountants), alleging negligence, gross negligence, and breach of fiduciary duty.

The second suit involved Fastlane Partner, LP (Fastlane), Don Smith, ANS Real Estate, Ltd. (ANS), and the Accountants. Fastlane asserted claims similar to Reagan with respect to Fastlane’s investment in Allen 75 and brought suit against the Accountants alleging fraud. In this suit, Don Smith and ANS asserted that Baumeister advised them to engage in a like-kind exchange rather than selling their property for cash. Baumeister advised Smith and ANS to invest indirectly in real property by acquiring interests in Houston Street Partners, LP (Houston LP), instead of taking the proceeds of their sale of an asset and investing it elsewhere. Smith and ANS both claimed that Baumeister failed to disclose that the property owned by Houston LP appraised for less than their purchase price, and had they known of this fact, they would not have purchased the property. As a result, Smith and ANS brought suit against the Accountants alleging negligence, fraud, and excessive fees.

Because both limited partnerships—Allen 75 and Houston LP—included an arbitration clause, the Accountants moved to compel arbitration in both suits. The Accountants argued that the claims of Reagan, Fastlane, Smith, and ANS (collectively Investors) arose from their investments in the limited partnerships and that the relevant limited partnership agreements required these claims to be resolved through arbitration. The trial court denied the Accountants’ motion to compel arbitration and the Accountants appealed.

The court of appeals first looked at whether the arbitration clause in the limited partnership agreement was ambiguous. The arbitration clause (Section 9.1) in the limited partnership agreements provided that “[a]ny dispute or controversy arising out of, under, in connection with or in relation to” the limited partnership agreement that “cannot be resolved under Section 9.1” must be resolved by arbitration. Stated differently, the arbitration provision stated that if a dispute under the limited partnership agreement could not be resolved through arbitration, it should be resolved through arbitration.

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136. Id. Reagan claimed that had he known about Baumeister’s interest in the partnership, he would not have made the investment. Id.
137. Id.
138. Id.
139. Id. (claiming that Baumeister (1) solicited $180,000 investment from Fastlane to become a new limited partner in Allen 75; (2) failed to disclose he was a partner in the partnership; (3) failed to disclose that he was going to make a substantial profit from the transaction; and (4) if Fastlane had known about Baumeister’s interest in the partnership, it would not have made the investment).
140. Id.
141. Id.
142. Id.
143. Id.
144. Id.
145. Id.
146. Id.
147. Id. at *3.
148. Id.
149. Id. Stated differently, the arbitration provision stated that if a dispute under the limited partnership agreement could not be resolved through arbitration, it should be resolved through arbitration.
court of appeals noted the circular nature of this clause, the court held that it was not ambiguous.\textsuperscript{150} In fact, the court concluded that the clause evidenced a clear intent to arbitrate unresolved disputes instead of any other dispute resolution method.\textsuperscript{151}

The court based its rationale on the Federal Arbitration Act, which reflects a liberal policy favoring arbitration.\textsuperscript{152} The court explained that in interpreting an arbitration clause, courts generally apply standard principles of contract interpretation and construction.\textsuperscript{153} If the language is not clear enough to decipher the parties' intent, courts must resolve any doubts about the scope of an arbitration clause in favor of arbitration.\textsuperscript{154}

The appellate court next examined the scope of the arbitration clause.\textsuperscript{155} The court stated that a claim is arbitrable "[i]f the facts alleged 'touch matters,' have a 'significant relationship' to, are 'inextricably enmeshed' with, or are 'factually intertwined' with the contract containing the arbitration [clause]."\textsuperscript{156} Conversely, the court stated that a claim is not subject to arbitration "if the facts alleged in support of the claim stand alone, are completely independent of the contract, and the claim could be maintained without reference to the contract."\textsuperscript{157}

The Investors asserted that their claims were not based on the limited partnership agreement and that they were not alleging that Baumeister breached the limited partnership agreements.\textsuperscript{158} Instead, their claims were solely based on Baumeister's breach of his duties as their CPA.\textsuperscript{159} Further, the Investors contended that the actions they complain of took place before the limited partnership agreements were executed.\textsuperscript{160} Even though these facts supported the conclusion of nonarbitrability, the court of appeals concluded that the Investors' claims were "related to," "inextricably enmeshed," and "factually intertwined with" the limited partnership agreements.\textsuperscript{161} The court found that the arbitration clause in the limited partnership agreement was broad enough to encompass the Investors' claims against Baumeister.\textsuperscript{162}

The court of appeals conceded that it was a unique set of facts and a close call, but it had to resolve its doubts in favor of arbitrability.\textsuperscript{163} Regarding the

\begin{itemize}
\item \textsuperscript{150} Id. at *4.
\item \textsuperscript{151} Id.
\item \textsuperscript{152} Id. at *3.
\item \textsuperscript{153} Id.
\item \textsuperscript{154} Id.
\item \textsuperscript{155} Id. at *4. To determine the scope of an arbitration clause, courts focus on the factual allegations, rather than the legal claims. Id.
\item \textsuperscript{156} Id.
\item \textsuperscript{157} Id.
\item \textsuperscript{158} Id. at *5.
\item \textsuperscript{159} Id. The Investors stated that Baumeister was their CPA for many years and so their claim was based on his faulty or deceptive advice and counsel, which had nothing to do with the limited partnership agreements. Id.
\item \textsuperscript{160} Id.
\item \textsuperscript{161} Id.
\item \textsuperscript{162} Id. at *6.
\item \textsuperscript{163} Id. This was because the Federal Arbitration Act reflects a favorable policy regarding arbitration and courts are required to resolve any doubts about the scope of an arbitration clause in
\end{itemize}
Investors’ claims against the CPA firm, the court found them to be arbitrable because they only arose out of a vicarious liability theory for the acts of Baumeister, which necessarily implicated the limited partnership agreement.\textsuperscript{164} Further, the court noted that the arbitration clause did not limit its scope solely to disputes between the parties to the limited partnership agreement.\textsuperscript{165} Hence, the court of appeals concluded that the trial court erred by refusing to compel arbitration of the Investors’ claims against Baumeister and the CPA firm.\textsuperscript{166}

\textit{Baumeister} highlights the Texas courts’ strong preference in favor of arbitration clauses.

\section*{VII. CONCLUSION}

Although the Survey cases are certainly not a scientific sample, it is interesting that an increasing percentage of cases during each Survey period address LLCs rather than partnerships. Although this trend is likely somewhat slower in Texas than in other states due to the passive income exemption to the Texas franchise tax that applies to limited partnerships but not LLCs, all anecdotal evidence points to the increasing use in Texas of LLCs over limited partnerships.\textsuperscript{167} Indeed, a few of the cases above render holdings specific to LLCs.\textsuperscript{168} Two of those cases concern the confusing but important topic of fiduciary duties.\textsuperscript{169} Based on these cases, it appears that courts are hesitant to automatically impose fiduciary duties among members of a Texas LLC, particularly in circumstances in which the members are adverse litigants. It also appears that piercing the veil of an LLC is at least as hard as piercing the veil of a limited partnership.

There were also instructive holdings as to joint ventures that were not specific to LLCs. Based on \textit{Gunda Corp.}, it is evident that conversions will not be treated as the creation of a new entity.\textsuperscript{170} There are probably many conclusions to be drawn from the fascinating \textit{Elliott} case, but one take-away is that when an owner of a joint venture enters into a transaction with the joint venture, the owner (and the joint venture) should review the joint venture agreement to insure that there is no provision of the joint venture agreement that could conceivably be read to govern and conflict with the owner-joint venture transaction.\textsuperscript{171}

\begin{footnotesize}
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\item favor of arbitration. \textit{Id.}
\item \textsuperscript{164}. \textit{Id.} at *7.
\item \textsuperscript{165}. \textit{Id.}
\item \textsuperscript{166}. \textit{Id.} at *8.
\item \textsuperscript{167}. See generally TEX. TAX CODE ANN. §§ 171.0002(a), 171.0003 (West 2008 & Supp. 2014).
\item \textsuperscript{169}. In re Hardee, 2013 WL 1084494; Tex. Standard Oil & Gas, L.P., 394 S.W.3d at 753.
\item \textsuperscript{170}. See \textit{Gunda Corp.}, LLC v. Yazhari, No. 14-12-00263-CV, 2013102440577 (Tex. App.—Houston [14th Dist.] Feb. 5, 2013, no pet.).
\item \textsuperscript{171}. See \textit{Elliott} v. Rockwood Vill. Partners, Ltd., No. 03-12-00298-CV, 2012 WL 6554826 (Tex. App.—Austin Dec. 12, 2012, no pet.).
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