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PARTNERSHIPS

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I. CASES

A. NO WHISTLEBLOWER EXCEPTION TO THE AT-WILL NATURE OF PARTNERSHIPS—*BOHATCH V. BUTLER & BINION*[1]

IN *Bohatch*, the Supreme Court of Texas established the rule that a law partnership has no tort liability to a partner whom it expels after the partner makes an accusation that another partner has committed an ethical violation.[2] In defending its decision against concurring and dissenting opinions, the court emphasized the potential damage that such an accusation, even if ethically required, could do to partners' relationships with one another.[3]

Bohatch became an associate in the Butler & Binion Washington, D.C. office in 1986. In 1990, Bohatch was made a partner of the firm. After reading internal billing reports, Bohatch became concerned that one partner in her office was overbilling a client. In July 1990, Bohatch discussed her suspicions with members of the firm's management committee. The managing partner reviewed the bills and spoke with the client, who felt that the bills were reasonable. In August 1990, the firm's managing partner informed Bohatch that the investigation revealed no evidence to support her complaint. He also told her that she would continue to receive her monthly draw and be allowed to keep her office space but that she should look for work elsewhere. In January 1991, Bohatch received no year-end distribution, and the firm reduced her 1991 tentative share to zero. She received her last monthly draw in June 1991. The firm expelled her three days after she filed suit against them.[4]

The trial court allowed Bohatch's breach of fiduciary duty and breach of contract claims to go to the jury. The jury awarded Bohatch $57,000 in lost wages, $250,000 for mental anguish, and $4,000,000 in punitive dam-

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1. 977 S.W.2d 543 (Tex. 1998); the court of appeals' decision was discussed in the 1997 Survey at 50 SMU L. REV. 1393 (1997).

2. *See id.* at 597.

3. *See id.*

4. *See id.* at 545.

ages.[5] The trial court reduced the punitive damage award to $237,000.[6] Both parties appealed. The appeals court reversed the award, holding that Bohatch's only entitlement was not to be expelled in bad faith and that there was no evidence of bad faith.[7] Bohatch appealed to the Supreme Court of Texas.

The Texas Supreme Court defined the issue in the case to be whether the fiduciary relationship between partners creates an exception to the at-will nature of partnerships.[8] Because this was an issue of first impression in Texas,[9] the court examined the law of other jurisdictions.[10] Based on that review, the court held that:

> [j]ust as a partner can be expelled, without a breach of any common law duty, over disagreements about firm policy or to resolve some other "fundamental schism," a partner can be expelled for accusing another partner of overbilling without subjecting the partnership to damages. [Charges of overbilling,] whether true or not, may have a profound effect on the personal confidence and trust essential to the partner relationship.[11]

The court rejected Bohatch's argument that public policy requires a limited duty to remain partners with a whistleblower.[12] It did not believe that permitting retaliation against a whistleblowing partner would tend to discourage compliance with the Rules of Professional Conduct. The court emphasized that its refusal to create a whistleblower exception to the at-will nature of partnerships did not release lawyers from their ethical duties.[13]

Not all of the Justices agreed with this decision. Chief Justice Phillips joined Justice Spector in a dissenting opinion.[14] Their dissent centered on the idea that the practice of law is a profession, and therefore, lawyers

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5. *See id.*

6. *See id.*

7. *See id.* The court defined "expulsion in bad faith" to mean expulsion for self-gain.

8. *See id.* The court began its opinion with this statement: "Partnerships exist by the agreement of the partners; partners have no duty to remain partners." *Id.* at 544.

9. *See id.* The court found that no statutory law applied to the case. *See id.* at 545-46. The Texas Uniform Partnership Act, which was in effect at the time the partnership was created, did not govern a situation in which a partner is expelled but the partnership survives. *See id.* The court further held that the Texas Revised Partnership Act did not apply because the partnership was created before its effective date. *See id.* For a further discussion of which partnership statute applied to a given partnership, see Section II of the Article.

10. The court cited three rules of law from other jurisdictions. *See id.* First, a partner may be expelled from a partnership for purely business reasons. *See id.* Second, a law firm may expel a partner to protect relationships within the firm as well as with clients. *See id.* Third, "a partnership can expel a partner without breaching any duty in order to resolve a 'fundamental schism.'" *Id.*

11. *Id.* at 546-47.

12. *See Bohatch*, 977 S.W.2d at 546.

13. *See id.* at 547. The court further stated, "[Ethical] duties sometimes necessitate difficult decisions, as when a lawyer suspects overbilling by a colleague. The fact that the ethical duty to report may create an irreparable schism between partners neither excuses failure to report nor transforms expulsion as a means of resolving that schism into a tort." *Id.* at 547.

14. *See id.* at 558.

should not be able to create agreements that allow them to avoid their ethical obligations.[15] The dissent's main concern was that the majority opinion would discourage attorneys from meeting their ethical obligations.[16] The majority responded to the dissent, saying that it failed to answer the question of how a law partnership could survive an accusation of ethical misconduct.[17]

In addition to the dissent, Justice Hecht wrote a lengthy concurring opinion.[18] Justice Hecht felt that Bohatch was rightfully expelled from the partnership because her mistaken accusation, although in good faith, was an exercise of bad judgment.[19] But he was concerned that the court was making an absolute rule before the issues were fully developed. Justice Hecht advocated waiting to deal with the case of a whistleblower who accurately reported an ethical violation.[20]

B. FORMATION—A PARTNERSHIP IS NOT FORMED BY A MERE AGREEMENT TO PAY BEFORE EXPENSE ROYALTIES—*SCHLUMBERGER TECHNOLOGY CORP. V. SWANSON*[21]

In *Schlumberger*, the Texas Supreme Court held that the payment of a pre-expenses royalty does not constitute profit sharing for purposes of determining whether a partnership exists under the Texas Uniform Partnership Act.[22] In this case, the Swanson brothers approached SEDCO, Inc. about mining diamonds off the coast of South Africa. In October 1978, SEDCO agreed to a three phase project under which it had full discretion over progressing from phase to phase.[23] Under the agreement, the Swansons were to obtain all necessary government approvals and licenses and were to provide information about diamond mining. In re-

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15. *See id.*

16. *See id.*

> Even if a report turns out to be mistaken or a client ultimately consents to the behavior in question, as in this case, retaliation against a partner who tries in good faith to correct or report perceived misconduct virtually assures that others will not take these appropriate steps in the future.

Bohatch, 977 S.W.2d at 561.

17. *See id.* at 547. The majority was afraid that the threat of tort liability would lead to a partnership's retention of partners in an atmosphere of suspicion and anger that would disable the partnership from serving the partnership's clients' interests because the partners would be so distracted by the internal friction. *See id.*

18. *See id.*

19. *See id.* at 548. "[E]xpulsion for *mistakenly* reporting unethical conduct cannot be a breach of fiduciary duty." *Id.* at 555.

20. *See id.* "I cannot, however, extrapolate from this case, as the [c]ourt does, that no law firm can ever be liable for expelling a partner for reporting unethical conduct." *Id.* The majority opinion responds to this criticism, stating that a clear rule is most effective. *See id.* at 547.

21. 959 S.W.2d 171 (Tex. 1997).

22. *See id.* at 176.

23. *See id.* at 173. The first phase of the project was to determine whether it was feasible. The second phase involved acquiring a lease. The third phase was to do commercial mining. *See id.*

turn, they were to receive consulting fees and a royalty.[24] SEDCO was to pay all the expenses for each phase of the project.[25]

The South African government granted leases to SEDCO and to other mining companies. The mining companies negotiated a joint venture agreement for the exploration and mining of their combined leased area. Sedswan, a sucessor[26] to SEDCO, entered the joint venture with the other mining companies in February 1985. Two years later, after some disputes with the Swansons, Schlumberger gave notice to the other mining companies that Sedswan was withdrawing from the joint venture. In accordance with the joint venture agreement, it offered to let the other companies acquire its interest.[27] During the negotiations over the price of Sedswan's interest in the joint venture, Schlumberger discussed the proposals with the Swansons.[28] The Swansons eventually released their interest for 2,000,000 rand.[29] In the release, the Swansons specifically agreed that they were not relying on any statements made by Schlumberger. Schlumberger then sold Sedswan's interest in the joint venture to the other mining companies for 10,000,000 rand.[30]

The Swansons sued Schlumberger in Texas, claiming that Schlumberger fraudulently misrepresented the project's viability and value and that it had breached its fiduciary duty to the Swansons as its partner. The trial court sent both claims to the jury, which found for the Swansons.[31] The trial court rendered a judgment notwithstanding the verdict, but the court of appeals reversed and remanded the case with instructions to reinstate the jury verdict.[32] Schlumberger appealed to the Texas Supreme Court.

On the issue of breach of fiduciary duty, the court first stated that if Schlumberger were the Swansons' partner, it would have had a fiduciary duty toward them when it bought their interest.[33] The court found, however, that the Swansons did not present sufficent evidence of the four elements required to prove a partnership under the Texas Uniform Partnership Act (TUPA).[34] In particular, the court found that there was no

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24. *See id.* The Swansons also had the right to purchase up to five percent of the shares of any company SEDCO formed to mine the diamonds. *See id.*

25. *See id.*

26. Schlumberger Technology acquired SEDCO, which became Sedswan. *See id.*

27. *See id.* The other companies would not agree to a price until they were sure that the Swansons no longer had any rights in the project. *See id.*

28. *See id.* The Swansons claimed Schlumberger was holding back information, and Schlumberger disputed the Swansons' rights altogether. *See id.*

29. The rand is the currency of South Africa. At the time, 2,000,000 rand was roughly equivalent to $814,000 in United States currency. *See id.*

30. *See id.* Ten million rand was roughly equivalent to $4,100,000. *See id.* After recouping its investment and paying off the Swansons, Schlumberger netted about 800,000 rand (approximately $319,000) from the project. *See id.*

31. *See id.*

32. *See id.* at 175.

33. *See id.* The fiduciary duty compels a partner who buys the interest of another partner to disclose all important information relating to the value of the interest. *See* Johnson v. Peckham, 132 Tex. 148, 120 S.W.2d 786, 788 (1938).

34. *See Schlumberger*, 959 S.W.2d at 176. The court found that the TUPA applied to the agreement because it was formed before the effective date of the Texas Revised Part-

evidence of an agreement to share profits.[35] It held that although the Swansons were entitled to receive a royalty under the agreement, the royalty was to be paid before expenses and, therefore, did not constitute profit.[36] The court also held that the consulting fees were not profit sharing, but rather compensation for services rendered.[37] Finally, the court rejected the Swansons' argument that Schlumberger's payment to them in return for their interest in the joint venture proves a partnership relationship.[38] The court found that all that the release of interest agreement proved was that the Swansons had some economic interest in the joint venture project, but that it would be circular logic to use its existence to conclude that it was a partnership interest.[39]

This case also dealt with an important non-partnership issue involving the effectiveness of a release that disclaimed reliance on representations of the release party in the face of a claim of fraudulent inducement. Under the circumstances of the case, the court found the release to be effective.[40]

C. PARTNERSHIP ASSETS—OWNERSHIP OF PROPERTY AS A PARTNERSHIP ASSET IS DETERMINED BY INTENTION—*FOUST V. OLD AMERICAN COUNTY MUTUAL FIRE INSURANCE CO.*[41]

In *Foust*, the Court of Appeals was called upon to determine whether an automobile that had been damaged in a hail storm was covered by an insurance policy.[42] To do this, the court had to decide whether Mr. Foust or the partnership that operated his business, Budget Auto, owned the automobile.[43] The insurance company claimed that because Foust purchased the car for business rather than personal use, it was not covered under Mr. Foust's personal automobile insurance policy.[44]

The court rejected the insurance company's argument that Foust bought the car in his capacity as a partner for the partnership.[45] The court first noted that when a partnership is named in an instrument that transfers title of an asset, the partner takes title on behalf of the partner-

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nership Act in 1994. *See id.* The court stated the four elements: (1) a community of interest; (2) an agreement to share profits; (3) an agreement to share losses; and (4) a mutual right of control or management of the entity. *See id.*

35. *See id.*

36. *See id.* "Entitlement to a royalty based on gross receipts is not profit sharing." *Id.* In fact, TUPA Section 7(3) says that "sharing of gross returns does not of itself establish a partnership, whether or not the persons sharing them have a joint or common right or interest in any property from which the returns are derived." TEX. REV. CIV. STAT. ANN. art. 6132b, § 7(3) (Vernon 1986).

37. *See Schlumberger*, 959 S.W.2d at 176.

38. *See id.*

39. *See id.*

40. *See id.* at 181.

41. 977 S.W.2d 783 (Tex. App.—Fort Worth 1998, no pet. h.).

42. *See id.* at 784.

43. *See id.* Foust purchased the automobile, but the title has "Budget Auto–Todd Foust as the buyer." *Id.* at 786.

44. *See id.*

45. *See id.*

ship, not individually.[46] However, the court then stated that "under well-established partnership principles, ownership of property intended to be a partnership asset is not determined by legal title, but rather by the intention of the parties as supported by the evidence."[47] In the end, the court found that the insurance policy covered the automobile, because Foust and the partnership were at least co-owners.[48]

II. LEGISLATION

There was no new partnership legislation passed by the Texas Legislature during the Survey period. But it is important to remember that TUPA expired on January 1, 1999, leaving only the Texas Revised Partnership Act (TRPA)[49] in effect. The expiration of the TUPA will affect partnerships created before January 1, 1994, the effective date of TRPA, that chose (mostly by doing nothing) to remain governed by the TUPA.[50] Beginning January 1, 1999, the TRPA applies to all partnerships. But what does this mean exactly?

It is relatively clear that the TRPA governs all activities that take place after January 1, 1999, in all partnerships. But it is unclear whether the TRPA will apply retroactively to things that happened before January 1, 1999, involving partnerships that elected (by not affirmatively opting to have the TRPA apply to them earlier) to remain governed by the TUPA, or whether the TUPA will continue to apply to those situations. This question is not answered by the statute and has not been answered by Texas case law.[51]

46. *See id.*
47. *Id.*
48. *See id.* at 788.
49. *See* TEX. REV. CIV. STAT. ANN. art. 6132b (Vernon Supp. 1999).
50. *See* TEX. REV. CIV. STAT. ANN. art. 6132b, § 11.03(a)(2) (Vernon 1986).
51. Similar issues apply to limited partnerships. The Texas Uniform Limited Partnership Act expired on September 1, 1992, leaving only the Texas Revised Limited Partnership Act in effect. TEX. REV. CIV. STAT. ANN. art. 6132a-1 (Vernon Supp. 1999).