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Partnerships

Steven A. Waters

PARTNERSHIPS

*Steven A. Waters**

THERE were only a handful of noteworthy partnership law cases decided during this year's Survey period. For the reader's convenience, the cases are grouped under topical headings corresponding to the most important partnership law aspect of the case. The most important activity during the Survey period was the passage by the Texas Legislature of the Texas Revised Partnership Act.[1]

I. CASES

A. DISCHARGE OF PARTNER LIABILITY AFTER DISSOLUTION

Victoria Air Conditioning, Inc. v. Southwest Texas Mechanical Insulation Co.[2]

This case involves the claim of a partnership creditor, VAC, brought against a partner, Nabors, who left the partnership after the debt arose. Nabors' separation caused a dissolution of the partnership.[3] The other partner, Jupe, who was the only partner of the two who dealt with the creditor, continued the business after Nabors' departure.

Generally, when a Texas general partnership is dissolved, the partners continue to have liability for the debts of the partnership that existed at the time of dissolution.[4] A partner may, however, be discharged from liability by an agreement between the partner, the partnership creditor and a person or partnership that continues the business of the partnership after dissolution.[5] The key in this case is that such an agreement "may be inferred from the course of dealing between the creditor having knowledge of the dissolution and the person or partnership continuing the business."[6]

Perhaps surprisingly, the court stated that section 36(2) of the Texas Uni-

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

1. TEX. REV. CIV. STAT. ANN. art. 6132b (Vernon Supp. 1994).

2. 850 S.W.2d 720 (Tex. App.—Corpus Christi 1993, writ denied).

3. A partner's withdrawal causes a dissolution under § 29 of the Texas Uniform Partnership Act, TEX. REV. CIV. STAT. ANN. art. 6132b (Vernon 1970) [hereinafter Texas UPA]. Note that, effective January 1, 1994 for partnerships created after December 31, 1993 (or pre-existing partnerships that elect to be covered), the applicable general partnership statute in Texas is the Texas Revised Partnership Act, TEX. REV. CIV. STAT. ANN. art. 6132b. *See* discussion *infra* at n.43.

4. Texas UPA § 36(1).

5. Texas UPA § 36(2).

6. *Id.*

form Partnership Act had not been interpreted by Texas or federal courts.[7] Much of the opinion consisted of the court's recitation of facts supporting the inference of an agreement to release the partner who did not continue in the business.[8]

In the absence of helpful Texas law, the court looked to a Colorado case, *Wester & Co. v. Nestle*,[9] in which a landlord sued a retired partner on a partnership lease that fell into default after the retired partner assigned his interest in the partnership to the continuing partner, causing a dissolution. The Texas court felt that the key in *Wester* was that the landlord did nothing affirmative; it noted that the landlord did not object to a change in the parties and did not request that the retired partner remain liable.[10] As with this Texas case, the Colorado court was faced with simply finding enough evidence to support the trial court result.[11] With expressed reference to *Wester*, the Texas appellate court pointed out that VAC never objected to Nabors' absence and never requested that Nabors remain liable.[12]

If nothing else, this case should inspire creditors of dissolved partnerships to be vigilant about the continuing liability of former partners. Even when it seems redundant to the self-operative statutory scheme, creditors should communicate with all partners and former partners to preempt a contrary inference which, as this case shows, can be made on pretty skimpy evidence.[13]

B. EXISTENCE OF PARTNERSHIP

Ben Fitzgerald Realty Co. v. Muller[14]

The issue in this case was whether a partnership existed, as claimed by the plaintiff who was injured by a falling ceiling beam in her house constructed by the alleged partner of the defendants. The trial court rendered judgment

7. *Victoria Air*, 850 S.W.2d at 724. The absence of common law on this issue may indicate either that creditors are good at protecting themselves in this context (which certainly is typical in larger transactions) or that they, in fact, intend to look only to those continuing the business for satisfaction of the subject obligations.

8. To overturn the trial court finding, the appellate court was required to consider the evidence and inferences supporting the jury finding, in their most favorable light, and resolve conflicting evidence on any particular issue in favor of the jury's verdict. *Victoria Air*, 850 S.W.2d at 723. The verdict may be set aside by the appellate court only if the evidence is so lacking that the result is clearly wrong and unjust. *Id.* (citing Cain v. Bain, 709 S.W.2d 175, 179 (Tex. 1986)). *Id.* Thus, the evidence did not have to be compelling (and, it really was not).

9. 669 P.2d 1046 (Colo. App. 1983).

10. 850 S.W.2d at 724.

11. *Id.* at n.3.

12. It is odd that the court suggested that the creditor be required to request anything when, by the plain language of the statute, liability continues unless the creditor agrees to the contrary. The court's approach seems an inappropriate shift of responsibility regarding the continuing liability of the retiring partner. Again, however, the procedural context of the case placed the court in a position of looking for support for a jury verdict.

13. It was not enough for this court that Jupe was VAC's "contact person," something in the nature of the managing partner, with whom the creditor dealt exclusively regarding partnership matters before and after Nabors' retirement. 850 S.W.2d at 721.

14. 846 S.W.2d 110 (Tex. App.—Tyler 1993, writ denied).

in favor of the plaintiff against the defendants and the contractor/putative partner, Jack Jones. Jones did not appeal the verdict.[15] The plaintiff's petition named each of the defendants, individually, adding d/b/a Dickey Construction Company, but did not expressly allege that Dickey Construction Company was a partnership or that any of the other parties was a partner in a partnership.

The plaintiff was a real estate broker who worked with defendant Ben Fitzgerald and defendant Taylor Burns at defendant Ben Fitzgerald Realty Co. When plaintiff decided to build a house, she asked Burns to recommend a contractor, and he suggested non-appealing defendant Jones. Apparently, it became known that Fitzgerald, Burns and Jones had a business relationship involving the construction of speculative houses. Namely, Jones was the builder and Burns and Fitzgerald arranged financing. In the case of her custom house, plaintiff arranged her own financing. Their customary fifteen percent fee was reduced to twelve percent for plaintiff in recognition of her employment status with Ben Fitzgerald Realty Co. The fee was shared equally by Jones, Fitzgerald and Burns at the completion of construction.

In its discussion of whether a partnership existed, the court appropriately looked first to section 6(1) of the Texas Uniform Partnership Act, which defines a partnership as an "association of two or more persons to carry on as co-owners a business for profit,"[16] and sections 7(3) and (4), which provide that (i) the sharing of gross returns does not by itself establish a partnership and (ii) the receipt by a person of a share of the profits of a business is prima facie evidence that the person is a partner in that business.[17] The court also noted the well-established rule placing the burden of proof on the person seeking to establish the existence of a partnership.[18]

The court cited a number of Texas cases for the proposition that each of the following four elements must be found to establish the existence of a partnership: (1) a community of interest in the business venture; (2) an agreement to share profits; (3) an agreement to share losses; and (4) a mutual right of control or management of the entity.[19] The court further noted that partnerships and joint ventures were governed by the same rules, and that a joint venture was simply a partnership for a limited purpose.[20] If one of the four elements is missing, then according to the court, no partnership could be established.[21]

The court emphasized the agreed loss-sharing element, and specifically found it to be lacking here. The court therefore held that, as a matter of law,

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15. *Id.* at 113. As noted below, that was a big mistake on Jones' (or, perhaps, his insurer's) part.

16. Texas UPA § 6(1); *see also* 846 S.W.2d at 120.

17. Texas UPA § 7(3), (4).

18. 846 S.W.2d at 120 (citing Rogers v. Butler, 563 S.W.2d 840, 842 (Tex. Civ. App.—Texarkana 1978, writ ref'd n.r.e.)).

19. *Id.* (citing, among other cases, Coastal Plains Dev. Corp. v. Micrea, Inc., 572 S.W.2d 285, 287 (Tex. 1978)); Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704 (1956).

20. *Id.* That is the real distinction between the two, and usually is important only in circumscribing the mutual agency relationship enjoyed by partners.

21. *Id.* at 121.

there was no joint venture.[22] Under the facts of this case, the court found every element other than profit-sharing to be absent. In other words, it found no agreement to share losses, no community of interest in the business and no mutual right of control or management of the enterprise.[23]

C. U.C.C. FORECLOSURE NOTICE TO FEWER THAN ALL PARTNERS

Gray v. F.D.I.C.[24]

Although this case is more important for the Uniform Commercial Code issues, it involves potentially important partnership issues as well.[25] A brief statement of the facts will help frame the issues. First Mexia Bank, predecessor to the Federal Deposit Insurance Corporation (FDIC), made a loan to Jesse Jones, d/b/a Quality Pipe and Steel, which the jury later found to be a partnership between Mr. Jones and Mr. Gray. Mr. Gray guaranteed indebtedness of the partnership owed to the Bank to an agreed ceiling of $150,000. The loan at issue here, secured by oil field pipes and other tangible personal property, subsequently was divided into two separate notes. The notes were not paid at their scheduled maturity, and the Bank sued and obtained a default judgment against Jones. Thereafter, the Bank filed a claim against Gray's estate (the "Estate"),[26] based initially on the guaranty signed by Gray and, by amended petition, on the derivative liability of the Estate as successor to Gray's partner liability. Shortly after the claim was filed against the Estate, the Bank repossessed various items of collateral and, over several months, disposed of the collateral and applied the proceeds to the smaller of the two notes. Notices regarding foreclosure of the security interest in the collateral were given to Jones, but not to the Estate.[27]

After all of this activity ended, the principal legal and economic issue became the Estate's liability for an approximately $100,000 deficiency (essentially, the amount of the larger note) that remained unpaid after application

22. The court weaved back and forth between the terms "partnership" and "joint venture," making only the distinction noted in the text above regarding a more limited purpose. It is interesting to note, however, that the *Micrea* and Brown v. Cole, cases, cited *supra*, are considered by many Texas practitioners and commentators to represent a dubious judicial gloss that imposes loss-sharing as an additional element necessary to find the existence of a joint venture as opposed to a partnership. While practitioners and commentators have not understood the reason for the extra requirement, it has existed in Texas common law. But, it seems a departure even from that established rule to require loss-sharing as a mandatory legal element of a partnership. It does, however, strike this author as a relevant inquiry on the existence of co-ownership, a necessary statutory element.

23. In fact, the court also found no evidence that any of the defendants, including the non-appealing Mr. Jones, was negligent. Interestingly, the final judgment against Mr. Jones was found by the court not to establish liability even against Mr. Jones, which would have been a necessary predicate for establishing the vicarious liability of the other defendants had a partnership been found to exist.

24. 841 S.W.2d 72 (Tex. App.—Houston [1st Dist.] 1992, writ dism'd by agr.).

25. The partnership issues, which could have been quite interesting, were avoided by the court, as more fully discussed below.

26. Mr. Gray died between the time the note was split into two notes and the default. 841 S.W.2d at 75.

27. Apparently, Jones had always been the "main" partner with whom the creditor dealt regarding this loan.

of foreclosure sale proceeds to the smaller note. The court premised liability both on Gray's having been a guarantor and his having been a partner of the borrowing partnership.[28] There was no dispute that the Estate had successor liability under the Texas Uniform Partnership Act for Gray's liability as a partner.[29] At this point, however, commercial law took over and the issue became whether proper notice had been given to the Estate.[30]

Section 9.504(c) of the Texas Uniform Commercial Code requires that every aspect of the disposition of collateral by a secured lender be commercially reasonable, which includes that reasonable notification of the sale be sent by the secured party to the debtor.[31] In accord with the law in other states, Texas common law holds that if the commercial reasonableness requirement, including the reasonable notification element, is not satisfied, then the creditor is denied the right to maintain a deficiency claim for any balance of the debt owed after application of the proceeds of disposition of the collateral.[32] Thus, the issue became whether reasonable notification had been given to the Estate, and was framed by the court as follows:

> Instead, the narrow question [presented] is whether notice of intended disposition of collateral given to a surviving partner by a partnership creditor constitutes reasonable notification under section 9.504 to the estate of the deceased partner, when given at a time when the partnership creditor has actual knowledge of both the identity of the deceased partner and of his death.[33]

The FDIC contended that the question is answered by the Texas partnership statute. According to the Texas partnership statute, the death of Mr. Gray dissolved the partnership,[34] ending Mr. Jones' authority to act for the partnership, except to wind up the partnership under Texas UPA section 37 and bind the partnership to third persons as permitted under section 35.[35] Unfortunately, the court did not even reach the issue of whether Jones' lim-

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28. *Gray*, 841 S.W.2d at 85.

29. *Id.* at 83.

30. In fact, the approach taken by the court effectively eliminated the partnership issue, leaving the deciding analysis under § 9.504 of the Texas Uniform Commercial Code. TEX. BUS. & COM. CODE ANN. § 9.504 (Tex. UCC) (Vernon 1991).

31. TEX. BUS. & COM. CODE ANN. § 9.504 (Tex. UCC) (Vernon 1991). The term "debtor" is defined in Texas UCC § 9.105(4) to be "the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, ..." TEX. BUS. & COM. CODE ANN. § 9.105(4) (Tex. UCC) (Vernon 1991). This sounds like it clearly means that notice must be given to guarantors. But, § 9.105(4) goes on to say that where the debtor and owner of the collateral are not the same person, "debtor" means the owner of the collateral in any provision of Article 9 that deals with the collateral, and it means the obligor in provisions dealing with the obligation. *Id.* Both are dealt with in § 9.504. That is covered, it would seem, by the last clause of § 9.105(4), which says that "debtor" may include both an owner and an obligor "where the context so requires, ..." *Id.*

32. Tanenbaum v. Economics Laboratory, Inc., 628 S.W.2d 769, 771 (Tex. 1982).

33. 841 S.W.2d at 83.

34. Texas UPA § 31(4).

35. *Id.* Generally, the authority of a partner after dissolution is limited to actions consistent with winding up, which is the settlement of the business affairs of the partnership. In the usual context, this includes the disposition of partnership assets and payment of partnership creditors. Under the facts here, that situation is somewhat more involuntary, but with the same ultimate resolution — disposition of assets, payment of creditors.

ited authority under sections 37 and 35 of the Texas UPA included authority to accept notice on behalf of the estate of a deceased former partner under section 9.504 of the Texas Uniform Commercial Code.[36] Instead, the court concluded that, under all of the facts and circumstances present here, it was unreasonable not to give notification directly to the Estate. The opinion gives the sense that the court simply felt that it was too easy for notice to have been given directly to the Estate to allow the pursuit of a deficiency without it.[37]

It is unfortunate that the case did not squarely address the partnership issues of (1) a surviving partner's right to receive and deal with a section 9.504 notice in a winding up context and (2) whether section 9.504 notice must be given to partners of a general partnership as a condition to pursuing a deficiency against those partners.

D. PARTNER AND GUARANTOR LIABILITY ARE INDEPENDENT

Chambers v. NCNB Texas National Bank[38]

In this appeal from a summary judgment in favor of the Bank, the appellate court rather easily confirmed the liability of a partner/guarantor of a partnership debt that was later refinanced by the incorporated successor to the partnership. Although the court could have relied solely on its central basis for upholding the trial court's summary judgment imposing liability on the partner/guarantor — that the plain language of the guaranty required a continuation of liability after a change in status of the debtor — it reinforced its conclusion by referring to the guarantor's independent liability as a partner of the debtor partnership.[39]

II. STATUTORY CHANGES

The Texas Legislature enacted the Texas Revised Partnership Act[40] (TRPA) during the Survey period. The TRPA, the result of a five-year project of the Partnership Law Committee of the Section on Business Law of the State Bar of Texas (the "Partnership Committee") to revise the Texas

36. 841 S.W.2d at 83.

37. The court's determination to reach this result was apparent from its statement that "prudence and common sense" dictated that result because "the disposition of the Estate's assets was the responsibility of Mr. Gray's personal representative, *not* Jones, the personal representative was the relevant person to whom to give § 9.504 notice in order to preserve the right to reach those assets." 841 S.W.2d at 84. The court's use of the word "disposition" to refer to handling the Estate's assets was confusing because the court later in the same paragraph used "dispose" in reference to the collateral. Ironically, the creditor might have avoided the issue by ignoring the collateral and pursuing a claim directly against the Estate (the Bank did, in fact, file one before it disposed of the collateral), as successor to Gray's partner liability. The Bank also could have preserved its deficiency by making clear it was disposing of the collateral with respect to only one of the two notes secured by the collateral (here, the smaller note). Instead, the court found that the failure to give a required § 9.504 notice affects the deficiency right with regard to all cross-collateralized obligations, unless the creditor clarifies that its action is limited to particular obligations.

38. 841 S.W.2d 132 (Tex. App.—Houston [14th Dist.] 1992, no writ).

39. 841 S.W.2d at 134 n.2.

40. TEX. REV. CIV. STAT. ANN. art. 6132b (Vernon Supp. 1994).

Uniform Partnership Act, was inspired by the report of the UPA Revision Subcommittee of the Committee on Partnerships and Unincorporated Business Organizations, of the American Bar Association's Section of Corporation, Banking and Business Law,[41] and paralleled a similar project being undertaken beginning in August 1986 by the National Conference of Commissioners on Uniform State Laws. The principal changes made by the TRPA are briefly summarized below. Except as otherwise noted, all section references are to the TRPA.

A. VARIATION BY AGREEMENT; NON-WAIVABLE PROVISIONS

The partnership agreement controls the relations among the partners and their relationship to the partnership, and the statute is merely a fallback that supplies answers where the agreement is silent.[42] Very importantly, a few core items cannot be varied by agreement.[43] An agreement: (1) may not unreasonably restrict a partner's right of access to books and records; (2) may not eliminate the duty of loyalty under section 4.04(b);[44] (3) may not eliminate the duty of care under section 4.04(c);[45] (4) may not eliminate the obligation of good faith under section 4.04(d);[46] (5) may not vary the power of a partner to withdraw, except to require that notice of withdrawal be given in writing; (6) may not vary the right to expel a partner by court order under certain conditions;[47] (7) may not vary the requirement to wind up the partnership on the occurrence of certain events of withdrawal;[48] (8) may not restrict the rights of third parties under the TRPA; and (9) may not select a governing law that does not bear a reasonable relationship to the partners or to the partnership's business and affairs.

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41. The ABA subcommittee was formed in April 1984 to review the national UPA and report recommendations for change to the National Conference of Commissioners on Uniform State Laws. After approximately eighteen months of work, the subcommittee published a report entitled "Should The Uniform Partnership Act Be Revised?" which concluded that:

> the number, substantive importance, and pervasive nature of the changes needed to be made [to the UPA] justif[ied] a complete substantive and stylistic revision of the UPA. The revision should focus on resolving the practical problems that have arisen under the existing statue, many of which are due to the dichotomy between the entity and the aggregate theories that divided the original drafting committee.

Harry J. Haynsworth IV, et al., *Should The Uniform Partnership Act Be Revised?*, 43 BUS. LAW 121, 184 (1987).

42. TRPA § 1.03(a).

43. TRPA § 1.03(b).

44. One may specify activities that do not violate the duty of loyalty, if not manifestly unreasonable.

45. One may determine standards by which performance is measured, if the standards are not manifestly unreasonable.

46. One may determine the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable.

47. For example, the partner has acted wrongfully, has materially breached the partnership agreement or the partner's duty to the partnership or the other partners, or has engaged in conduct that made it not reasonably practicable to carry on the business in partnership with that partner.

48. For example, all of the partners have agreed to wind up, or it is illegal to continue the partnership's business, or a court orders the partnership to be wound up.

B. INTERNAL AFFAIRS DOCTRINE

The TRPA expressly allows partners to agree on the law to be applied to the partnership, if the state chosen bears a reasonable relation to the partners or to the partnership business under principles that apply to a contract among the partners other than the partnership agreement.[49] Absent a selection, the law of the state of the partnership's chief executive office applies.

C. STANDARD OF PARTNER'S CONDUCT

This arguably is the most significant provision of the TRPA. Section 4.04 prescribes general standards of a partner's conduct and, more importantly, states that a partner, as such, is not a trustee and is not held to the same standards as a trustee. The Partnership Committee intentionally avoided the term "fiduciary," fearing that the statutory duties might be expanded by introducing a loose use of that term from other contexts.[50]

The duties stated in section 4.04 are (1) a duty of loyalty, and (2) a duty of care that includes acting with the care of an ordinary prudent person in similar circumstances; an error in judgment does not by itself constitute a breach of this duty.[51]

D. WITHDRAWAL AND CONTINUATION

The withdrawal and continuation provisions of TRPA continue the modernization trend evident in the Texas Revised Limited Partnership Act.[52] For example, the term "dissolution" is not used in the TRPA. Rather, the existing Texas Uniform Partnership Act scheme of dissolution/winding up/termination has been replaced in TRPA by the concept of "event of withdrawal," which may or may not also be an event "requiring a winding up." Thus, the fallback of TRPA distinguishes among different circumstances under which a general partner separates from a partnership, providing for continuation under some of them and winding up under others. By contrast, the fallback of the Texas Uniform Partnership Act requires a winding up after a dissolution, *unless* partners have agreed otherwise - that is, to continue the partnership business.

The essential statutory scheme[53] provides that withdrawal of a partner does not require winding up, but requires redemption, a buyout of the withdrawn partner's interest at fair value, unless a majority-in-interest of the re-

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49. TRPA § 1.05.

50. It was felt that the concept of "fiduciary" was inappropriate to describe the duties of a partner who, unlike a true trustee, legitimately may pursue the partner's own self-interest and not solely the interest of fellow partners or the partnership.

51. Section 4.04(c), when taken together with § 4.04(d) which requires duties to be discharged in good faith and in a manner reasonably believed to be in the best interest of the partnership, makes the so-called "business judgment rule" applicable to partners, with the general standard of care being negligence.

52. TEX. REV. CIV. STAT. ANN. art. 6132a-1 (Vernon 1970 and Supp. 1992).

53. Remember, though, that the statute is mostly a fallback that can be varied by agreement of the partners.

maining partners choose to wind up.[54]

E. Exhaustion of Partnership Assets Before Collecting Partnership Debt from Individual Partner

Under the Texas Uniform Partnership Act, partners have joint and several liability for the debts and obligations of the partnership.[55] The same liability rule is continued in section 3.04 of TRPA except for registered limited liability partnerships, which is now covered by TRPA section 3.08. There is, however, a material change. Unlike the common law under the Texas UPA, which allows a creditor to bring an action directly against a partner without first seeking to satisfy the obligation from the partnership assets,[56] TRPA section 3.05 requires that partnership creditors first attempt to satisfy claims from partnership assets. There are a few important exceptions.[57]

F. Accounting no Longer Required as Prerequisite to Suing

As noted several times in the last few Survey articles, current Texas law requires an accounting to be brought as a prerequisite to one partner's suing another.[58] TRPA changes this, stating affirmatively that a partner may maintain an action against the partnership or another partner for legal or equitable relief. This includes an accounting, to enforce a right under the partnership agreement or under the TRPA.[59] Also, a partnership may maintain an action against the partner for breach of the partnership agreement or violation of the duty to the partnership.[60]

G. Effective Date

TRPA establishes an effective date of January 1, 1994.[61] This applies to a partnership formed after December 31, 1993, unless the partnership is continuing the business of a dissolved partnership under section 41 of the Texas UPA.[62] Pre-existing partnerships, those formed before January 1, 1994, may elect to adopt the TRPA by following the amendment procedures contained in their partnership agreement. After December 31, 1998, TRPA completely replaces the Texas Uniform Partnership Act.

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54. TRPA §§ 6.01 - 7.01.
55. Texas UPA § 15.
56. Foster v. Daon, 731 F.2d 148 (5th Cir. 1983).
57. Perhaps the most important exceptions are those (1) allowing the partnership and the creditor to waive the requirement and (2) providing for liability under other law, such as pursuant to a separate guaranty signed by the partner.
58. *See, e.g.*, Steven A. Waters and Matthew D. Goetz, *Partnerships, Annual Survey of Texas Law*, 45 Sw. L.J. 2011, 2021 n.83 (1992) (citing Kartalis v. Commander Warehouse Joint Venture, 773 S.W. 2d 393, 394 (Tex. App.—Dallas 1989, no writ)).
59. TRPA § 4.06(b).
60. TRPA § 4.06(a).
61. TRPA § 10.03.
62. Functionally, partnerships that have dissolved (often for technical reasons, such as on the departure of a partner), but continue their business without interruption, are not really the "new" partnerships the statute attempts to cover.