SMU | Dedman School of Law

SMU Law Review

Volume 48
Issue 4 *Annual Survey of Texas Law*

Article 22

1995

Partnerships

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Recommended Citation
Steven A. Waters, *Partnerships*, 48 SMU L. Rev. 1455 (1995)
https://scholar.smu.edu/smulr/vol48/iss4/22

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PARTNERSHIPS

*Steven A. Waters**

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THIS year's Survey contains an unusual proportion of Fifth Circuit and bankruptcy court cases among the few noteworthy cases. For the reader's convenience, the cases are grouped under topical headings corresponding to the most important partnership law aspect of the case.

I. DETERMINATION OF PARTNER STATUS

A. *BALLARD V. UNITED STATES*[1]

The issue in *Ballard* asked whether an individual who had a managerial relationship with a joint venture, and who was compensated from the profits of the venture, was a partner in the venture and, therefore, jointly and severally liable for the joint venture's obligations.[2] The issue was not, as it often is, whether a partnership existed; rather, the question was whether Ballard was a partner, or was an employee or agent compensated by reference to the venture's profits.[3]

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1. 17 F.3d 116 (5th Cir. 1994).

2. The particular obligation in this case was assessed payroll taxes not paid by the joint venture.

3. The court acknowledged well-established Texas law that a joint venture is a partnership and a joint venture member is a partner. 17 F.3d at 118.

Ballard brought a wrongful levy claim against the United States, prompted by an Internal Revenue Service seizure and application of a real estate commission payable to Ballard against the delinquent payroll tax liability of the Omni/Vanir Joint Venture. Ballard argued successfully on appeal that state law, not federal law, governed whether he was a partner, and liable as such.[4] Unfortunately for him, winning that point was about the only satisfaction Ballard could take from the case. The Fifth Circuit, applying Texas law, upheld the district court's conclusion that Ballard was a partner in the Omni/Vanir Joint Venture and, therefore, that he had joint and several liability for the joint venture's obligations, including the unpaid payroll taxes.[5]

The Fifth Circuit noted the four attributes required by Texas law to find a joint venture: "(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."[6] The court's application of those attributes to the facts of this case was not entirely satisfying. For example, the court stated at one point that Ballard expressly shared in the profits and losses of the joint venture.[7] By contrast, the court referred to an amendment to the Omni/Vanir Joint Venture Agreement that made Ballard a partner, stating "that Ballard would: (1) receive a five percent share in the profits and losses of Omni/Vanir; (2) not have to make a capital contribution in exchange for this interest; and (3) not share in the obligations of Omni/Vanir."[8] The court seemed to bootstrap this issue by first concluding that Ballard was a partner and, therefore, was liable for partnership obligations (thereby satisfying the loss-sharing requirement), and then finding that any limitation on Ballard's liability was only an agreement among partners that was not binding on third parties.[9]

The Fifth Circuit held that the "community of interest" requirement was satisfied by the partners' profit-sharing and guaranty of loans relating to the venture's various real estate projects.[10] Similarly, the court readily found that Ballard's active management of real estate projects for the joint venture satisfied the mutual right of control or management.[11]

4. The federal district court had held that federal law, which apparently defines partnerships more broadly than state law, governed. *Id.*

5. *Id.* at 119.

6. *Id.* at 118.

7. *Id.*

8. *Id.* at 117 (emphasis added).

9. *Id.* at 118.

10. *Id.*

11. *Id.* at 119. The court did acknowledge that Ballard's management authority was somewhat limited relative to other partners, but found it to be broad enough to support partner status.

B. PARTNER AND GUARANTOR LIABILITY ARE INDEPENDENT

1. *Commons West Office Condos v. Resolution Trust Corporation*[12]

This case began as a post-foreclosure declaratory judgment action by a partnership/borrower against its lender, seeking a declaration that the partnership had not defaulted on a loan. The original lender, Bexar Savings Association, was placed into receivership and its position succeeded to by the Resolution Trust Corporation (RTC), as receiver. The RTC filed a counterclaim against the partnership and a third party action against Clinton Weilbacher, individually under a guaranty and as general partner of the partnership. Weilbacher mistakenly believed that a provision in his guaranty that limited his liability to twenty-five percent of the partnership debts equally limited his liability as a general partner of the debtor partnership.[13] Citing established Texas law,[14] the 5th Circuit upheld the district court's finding that Weilbacher's 100% joint and several liability as a general partner[15] was independent of the guaranty limitation to twenty-five percent. The fact that Weilbacher subjectively intended to be liable only to the extent of twenty-five percent was found to be irrelevant.[16]

It is not uncommon in structuring real estate loan transactions to specifically take into account the distinction between a partner's liability for a partnership's obligation and separate liability as a guarantor. For example, a typical structure provides for a non-recourse partnership obligation (that is, there is no liability of the partnership or its partners to the lender), but then to obtain guaranties from one or more third parties, including some or all of the partners. A common additional feature would have the guaranties "burning off" after a certain portion of the loan was repaid or the income generated by the property collateralizing the loan reached and maintained a certain level for a specified period of time, or a combination of both.[17]

II. PARTNERSHIP AGREEMENT CONTROLS RELATIONSHIP

A. *EXXON CORPORATION V. BURGLIN*[18]

This was an appeal by four limited partners of a limited partnership, in which Exxon Corporation was the general partner, of a summary judg-

12. 5 F.3d 125 (5th Cir. 1993).

13. Or, Weilbacher was making any argument he could think of, acting as his own counsel.

14. Nance v. RTC, 803 S.W.2d 323 (Tex. App.—San Antonio 1990, writ denied).

15. TEX. REV. CIV. STAT. ANN. art. 6132b § 15 (Vernon Supp. 1995) [hereinafter TUPA].

16. *Id.*

17. With this kind of structure, until their liability as guarantors ended, the guarantors have joint and several liability for the entire debt. After the guaranties expire, the nonrecourse features at the partnership level would flow through to the partners, resulting in no personal liability for the indebtedness at either level. At that point, the lender must look solely to the collateral security.

18. 4 F.3d 1294 (5th Cir. 1993).

ment relating to Exxon's purchase of the limited partners' interests in the partnership.[19] The essence of the limited partners' claims was that Exxon was guilty of fraud, misrepresentation and breach of fiduciary duty in failing to disclose certain information affecting the valuation of the limited partners' interests acquired by Exxon.

The first issue decided by the court was that Alaska, not Texas, law governed, validating the choice made by the parties in the partnership agreement governing their relationship.[20] The court cited the seminal Texas case of *DeSantis v. Wackenhut Corp.*[21] for the rule that a Texas court will enforce a contractual choice of law "unless (1) the contract bears no reasonable relation to the chosen state or (2) the law of the chosen state violates a fundamental public policy of Texas."[22] The court logically concluded that Alaskan oil leases bear a reasonable relation to Alaska, but it seemed to overstate things when it said that "Exxon could not seriously contend that . . . Alaska contract law offends the public policy of Texas."[23] *Of course* there could be something in the contract law of Alaska that offends fundamental Texas public policy — that's the reason for the exception!

As a court applying Texas law would likely have done, the Fifth Circuit largely deferred to the partnership agreement in defining the general partner's duty, and in determining whether a failure to disclose in certain situations was a breach of that agreement.[24] The pertinent portion of the agreement stated that the general partner was not obligated to furnish certain types of information about leases that the general partner believed "would be in the best interest of the Partnership *or the General Partner* to be kept confidential."[25] The next sentence of the same provision of the partnership agreement did obligate the general partner to annually provide non-confidential information relevant to the evaluation of the partnership interest of each limited partner.[26] The court held that the first provision recognized the general partner's need to protect itself from the limited partners, in light of the limited partners' ability to engage in other ventures, including those that would be potentially competitive.[27] The court then seemed to go unnecessarily far when it said: "Since this provision abrogates the fiduciary duty of loyalty allowing partners to compete with their partnership, it is reasonable to expect some limitation on the fiduciary duty of disclosure."[28] Limited partners, and certainly

19. *Id.* at 1296.
20. Exxon was not a party to the original agreement, but succeeded to the interest of Chevron after purchasing Chevron's interest. 4 F.3d at 1298.
21. 793 S.W.2d 670, 677 (Tex. 1990).
22. 4 F.3d at 1298 n.5 (citing *DeSantis*, 793 S.W.2d at 677).
23. 4 F.3d at 1298, n.5.
24. *Id.* Texas Supreme Court strongly supported the notion of "primacy of contract" in Park Cities v. Byrd, 534 S.W.2d 668 (Tex. 1976).
25. 4 F.3d at 1299 (emphasis added).
26. *Id.*
27. *Id.*
28. *Id.*

any who are not involved in partnership activities, generally do not owe the same fiduciary duties that are owed to them by a general partner.[29] Therefore, in the absence of a contractual limitation on permissible activities of limited partners, which could give rise to a breach of contract action on a violation of the limitation, one ordinarily would not expect to find a fiduciary duty limitation imposed on limited partners.

The Fifth Circuit could have skipped the point made at the end of the preceding paragraph and relied, instead, on its next point — that the partnership agreement was an arm's length agreement negotiated between sophisticated parties with the assistance of counsel.[30] With the strong deference to the parties' agreement, and after having previously acknowledged that the parties had some freedom to alter their fiduciary duties in that agreement,[31] the court was obligated under Alaska law to honor the agreement. Therefore, after a brief diversion to determine that Exxon had not breached an implied duty of good faith and fair dealing, the only question left was whether Exxon, in fact, acted in accordance with the parties' agreement.[32]

The plain meaning of the words chosen by the parties in their agreement, as the court noted, was that the general partner was obligated to provide the limited partners with information necessary to evaluate their interests, *unless* the general partner believed that the information was confidential.[33] The general partner was contractually obligated to reach its conclusion "in the exercise of its reasonable discretion and in light of its fiduciary capacity,"[34] which the court concluded that it did.[35]

Although the court went to some lengths to carefully consider all of the limited partners' arguments and to respond to each one of them by applying law to facts, it seems relatively obvious that the court was essentially saying to the limited partners:

> You were well represented by counsel when you entered into this agreement; the agreement does not violate public policy; you made a decision to sell based on your personal financial need, when you could have deferred the decision until more information about a key, incomplete partnership oil well was known; you could have rejected the offer and continued as a partner or waited until additional information was available; and, on top of all of this, you even could have accepted the purchase price, then obtained a third party consultant's opinion of value and, after the fact, rescinded the transaction if you

29. ALAN R. BROMBERG AND LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIPS § 6.07(a), at 6:70 n.5 (1994).

30. 4 F.3d at 1299.

31. *Id.* at 1298 (citing to BROMBERG AND RIBSTEIN ON PARTNERSHIPS § 6.07(h), at 6:89 (1991) and § 6.06, at 6:67 (arguing that "parties could at least circumscribe the right to information") and § 6.05(d), at 6:59 (noting that parties can bargain over access to information)).

32. 4 F.3d at 1299.

33. *Id.* at 1300.

34. *Id.*

35. *Id.*

believed that you were inadequately compensated. Under all these facts, we find that you were not treated unfairly.

The court did leave open the pursuit of potential claims for fraud or misrepresentation, on which it offered no opinion.[36]

III. STATUTE OF LIMITATIONS — PARTNER LIABILITY FOR PARTNERSHIP OBLIGATIONS

A. *RTC v. Bonner*[37]

Perhaps the first thing that one notes about *Bonner* is the number of lawyers involved, which is not surprising given that it is a suit against former officers and directors of a savings and loan association and against a law partnership and its individual partners. In what many believe to be as much an attempt to recover funds from the deepest pockets in the neighborhood (i.e. insurance carriers providing directors and officers insurance and law firm professional liability insurance coverages), the RTC has aggressively (some would say *wantonly*) pursued former directors and officers and their professional advisers (lawyers and accountants).[38]

In this summary judgment action,[39] the two main issues to decide were (1) the applicable statute of limitations[40] and (2) how limitations should be applied to a partnership and its partners. On the first issue, the court noted that the relevant statute of limitations under Texas law, both for claims for breach of fiduciary duty and legal malpractice,[41] was the basic tort two-year statute.[42] The RTC, which succeeded the Federal Home Loan Bank Board when the savings association moved from conservatorship to receivership, argued that 12 U.S.C. section 1821(d)(14) called for a three-year statute of limitations.[43] The court found the three-year statute to be applicable.

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36. *Id.* at 1302.

37. 848 F. Supp. 96 (S.D. Tex. 1994).

38. The RTC's claim identified 14 transactions as the basis for its suit against the law firm and its partners, the entire premise for which was that one of the firm's partners was a director of the savings association that was the lender in the transactions. The court quickly granted summary judgment on the 12 of the 14 transactions in which the law firm had performed no legal services.

39. The summary judgment involving the 12 transactions on which the law firm had performed no legal services, *supra* note 38, left 2 transactions in which the law firm performed legal services, which are the basis for the opinion.

40. The parties agreed that the relevant statute began to run on the date that the Federal Home Loan Bank Board was appointed conservator for University Federal Savings Association.

41. The basis of the suit here was breach of fiduciary duty, professional malpractice, aiding and abetting breach of fiduciary duty, and vicarious liability. 848 F. Supp. at 97.

42. TEX. CIV. PRAC. & REM. CODE § 16.003 (Vernon 1986).

43. That section provides that "the applicable statute of limitations with regard to any action brought by the Corporation as conservator or receiver shall be . . . in the case of any tort claim, the longer of (I) the 3-year period beginning on the date the claim accrues; or (II) the period applicable under State law." 12 U.S.C. § 1821(d)(14) (1988).

The main issue in the case was the effect on non-signatory partners of a tolling agreement signed only by the partnership and one partner.[44] The RTC brought its claim against the individual partners after three years from the date the statute of limitations began to run on the claim against the partnership. The court seemed to take an "entity theory" of partnership line of reasoning to support its conclusion that the partnership's execution of the tolling agreement extending the statute of limitations did not bind the individual partners.[45] Although the court supports its opinion with statutory citations,[46] it seems primarily to base its conclusion on the parties' *intent.* The court simply felt that the terms of the tolling agreement itself indicated an intent that the individual partners who did not sign it were not to be bound by it. The court linked the following: (1) although "partners are jointly and severally liable for the debts . . . of the partnership,"[47] "[a] judgment against [the] partnership is not by itself a judgment against a partner;"[48] (2) a judgment can be entered "against an individual partner only when that partner has been timely served with process in the same suit;"[49] (3) the individual assets of a partner are not subject to pursuit by a partnership creditor unless a judgment has been entered against the individual partner;[50] and, therefore, (4) the individual partners' assets are not exposed to liability for the partnership's obligations unless a judgment is obtained against the partner, individually.[51]

Perhaps the strongest position taken by the court, and one that is very dubious, is summarized in the following sentence: "Rather, just as the individual partner must be individually served with process in order to be bound in his individual capacity by a judgment against the partnership, the individual partner must be named or expressly bound by a contract signed on behalf of the partnership in order to be bound by such contract."[52] Does this mean that if a partnership validly executes a promissory note to evidence a loan from a bank, then no individual partner is

44. The tolling agreement was signed by the law firm's administrative partner and by the individual partner who was the director of the savings association, but by none of the other partners.

45. The court said that if the individuals had been intended to be bound by the tolling agreement, there could have been included a reference to "SCW and its partners." 848 F. Supp. at 99. Note the use of the entity theory in *In re* Jones, *infra* note 55, to reach a directly contrary result.

46. 848 F. Supp. at 99. Curiously, the only partnership statutory citations used by the court were to the Texas Revised Partnership Act, TEX. REV. CIV. STAT. art. 6132b-1.01 to -13.09 (Vernon Supp. 1995), [hereinafter TRPA] which did not become effective until January 1, 1994, and which is not applicable to the partnership matters at issue in this case. The TUPA does not apply to pre-existing partnerships that do not voluntarily accept application of the new statute, until January 1, 1999.

47. 848 F. Supp. at 99. Again, the court cited to the TRPA § 3.04 instead of the TUPA § 15.

48. 848 F. Supp. at 99 (construing TRPA § 3.05).

49. *Id.*

50. *Id.*

51. 848 F. Supp. at 100.

52. *Id.*

liable unless it is "named or expressly bound by" that note? It just cannot mean that.

The author understands the interplay of Texas partnership law and civil procedure law to require that a partner be named and a judgment obtained against it before a partner's individual assets may be pursued.[53] This means that a judgment obtained against a partnership in a case in which a partner has not been named is not sufficient to support direct pursuit of the partner's individual assets. On the other hand, because a partner is jointly and severally liable for the obligations of the partnership,[54] such a judgment does serve as a basis to bring an individual claim against the partner for that liability established against the partnership. If the court here believed the law to be that filing a suit against the partnership did not toll the statute of limitations against a partner not named in the suit, it should have limited its holding to that basis. The following case reaches a different result, although the tolling agreement/intent analysis emphasized in the *Bonner* court arguably supplies a basis on which *Bonner* and *In re Jones* can be reconciled.

B. *IN RE JONES*[55]

This case involves essentially the same issue that was involved in *RTC v. Bonner*, immediately above, but reaches a different and, the author believes, correct result. Here, the Trustee-in-Bankruptcy for the Jones' obtained a judgment against a partnership that it was unable to satisfy from partnership assets. The Trustee therefore sought a personal judgment against the partners for the partnership's liabilities. The partners defended the Trustee's claim, in part, on the ground that the statute of limitations had expired on a claim against them. None of the partners was named in the suit against the partnership, although some appeared as representatives of the partnership. The key issue in the case was determining when the statute of limitations began to run on the claims made against the individual partners.

The court began by identifying the relevant statutory principles, including the governing four year statute of limitations,[56] the two provisions governing service on a partnership and partners and taking judgments against them,[57] and the basic joint and several liability of partners under the Texas Uniform Partnership Act.[58] The court correctly stated that these statutory provisions "make it clear that partners are jointly and sev-

53. TEX. CIV. PRAC. & REM. CODE (TCPRC) §§ 17.022, 31.003; TUPA § 15.
54. TUPA § 15.
55. 161 B.R. 180 (Bankr. N.D. Tex. 1993).
56. TCPRC § 16.004(a)(3).
57. TCPRC § 17.022 provides that service on one member of a partnership authorizes judgment against the partnership and the partner actually served, and TCPRC § 31.003 provides that a suit against several partners with joint liability under a contract allows judgment against the partners actually served, but not a personal judgment or execution against any partner who was not served.
58. TUPA § 15.

erally liable for the debts of the partnership and that a judgment against the partner can be obtained in a suit against the partnership."[59]

Against that background, the court discussed three cases,[60] following one,[61] refusing to follow one[62] and distinguishing the third.[63] The court stated clearly its conclusions: "Limitations began to run against the partners only when the district court's judgment became final. Clearly, this action was brought within the four-year statute of limitations . . . ."[64] The court declined to follow the *Cothrum Drilling Co.*[65] ruling on the ground that it relied on pre-Texas Uniform Partnership Act law that followed the aggregate theory more than the entity theory represented by the partnership act.[66] As noted, the court distinguished the *Cissne* case.

The court concluded its analysis with an ironic use of the principle of res judicata. The defendants asserted that the Trustee's claims were barred by res judicata, effectively urging that the Trustee's failure to make them defendants in the action against the partnership barred the Trustee from relitigating the same issues. The court responded that the issues were not being relitigated; rather, liability was first being established against the partnership and then the partners' individual liability under section fifteen of the TUPA was being pursued.[67] The irony was the court's statement that res judicata prevented the partners from relitigating liability already established against the partnership for which the partners then had liability under the partnership act.

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59. 161 B.R. 180, 182.

60. Each was discussed in an earlier issue of this survey. Carlyle Joint Venture v. Zachry, 802 S.W.2d 814 (Tex. App.—San Antonio 1990, writ denied) *discussed in* Steven A. Waters & Matthew D. Goetz, *Partnerships, Annual Survey of Texas Law*, 45 S.W. L.J. 2011 (1992). Cothrum Drilling Co. v. Partee, 790 S.W.2d 786 (Tex. App.—Eastland 1990, writ denied) and Cissne v. Robertson, 782 S.W.2d 912 (Tex. App.—Dallas 1989, writ denied) *discussed in* Steven A. Waters & Joni Gaylor, *Partnerships, Annual Survey of Texas Law*, 45 S.W. L.J. 553, 566-67 (1991).

61. *Carlyle*, 802 S.W.2d at 814.

62. *Cothrum Drilling*, 790 S.W.2d at 786.

63. *Cissne*, 782 S.W.2d at 912.

64. 161 B.R. 180, 183.

65. *Cothrum Drilling Co.*, 790 S.W.2d at 796.

66. 161 B.R. 180, 183. This author agrees with the court's assessment:

> Under the entity theory of partnerships, it is logical that a partner has no liability until the partnership liability is established. There is nothing wrong in allowing the partners to be sued along with the partnership so that once the partnership liability is established, a judgment can be rendered against the partnership and the partners. On the other hand, there is nothing wrong with the partnership being sued and, if its liability is established, a subsequent suit being filed against the partners on their personal liability for the partnership's obligation.

Id. The court in *Bonner*, *supra* note 37, disagreed.

67. 161 B.R. 180, 184.