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Partnerships

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PARTNERSHIPS

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I. INTRODUCTION

IT seems that a handful of Texas partnership cases surface each year. In some years, particularly in the recent past as the real estate industry (which utilizes the partnership as the predominant investment vehicle) suffered through hard times, many of the partnership law cases were decided in the bankruptcy courts. Occasionally there is a partnership law case or partnership legislation that is important to the state's jurisprudence.

It would be difficult to categorize any of the cases discussed in this article as "important," although some certainly are informative and notable. It was anticipated that there would be 1995 legislation to discuss; however, a political difference of opinion submarined the entire "Business Organizations Bill," which was not substantively controversial.[1] Because the bill is expected to be re-introduced, probably without change, in the 1997 session, pertinent portions of that legislation are briefly discussed.

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1. H.B. 1425, 75th Leg., C.S. (1995).

For the reader's convenience, the cases are grouped under topical headings corresponding to the most important partnership law aspect of the case.

II. CASES

A. EXISTENCE OF PARTNERSHIP; DETERMINATION OF PARTNER STATUS

One issue that generates a fair amount of litigation is the determination of whether a partnership exists. The issue arises in two principal contexts: (1) a person asserting that another is the first person's partner (either to have someone with whom to share liabilities or from whom profits can be obtained), and (2) assertion by a third party that a partnership exists between or among others with whom the third party has conducted business (usually in an effort to impose liability on someone who claims not to be another's partner). A related issue is whether a particular person who has a relationship with a partnership is a partner in that partnership.

Brazosport Bank of Texas v. Oak Park Townhouses.[2]

This case, which involved a loan by Brazosport Bank to Oak Park Townhouses, contained a number of issues; only the partnership issues, however, will be discussed.

In responding to the borrower's claim that Brazosport breached a fiduciary duty owed to the borrower, the court first had to determine whether a joint venture existed between the two. The borrower based its argument that a joint venture existed on the fact that the lender obtained an assignment of a profits interest in the borrower's project as additional consideration for its loan. The borrower's claim implicated a peculiar Texas rule that, to find the existence of a *joint venture*, the parties must agree to share *losses*.[3]

The four elements required to establish a joint venture under Texas law are: (1) community of interest in the venture, (2) an agreement to share profits, (3) an agreement to share losses, and (4) a mutual right of control over management of the enterprise.[4]

A joint venture does not exist if any of these four elements is missing. Here, the borrower argued that an agreement to share losses could be *implied* from an agreement to share profits, basing its assertion on the authority of *Austin v. Truly*[5] and *Couder v. Gomez*.[6] However, unlike here, in *Truly* and *Couder* there was an express joint venture relationship, and the court in *Brazosport* refused to bootstrap a finding of a joint venture by implying an agreement to share losses.[7]

2. 889 S.W.2d 676 (Tex. App.—Houston [14th Dist.] 1994, writ requested).
3. *Id.* at 682.
4. Coastal Plains Dev. Corp. v. Micrea, Inc., 572 S.W.2d 285, 287 (Tex. 1978).
5. 721 S.W.2d 913 (Tex. App.—Beaumont 1986), *aff'd*, 744 S.W.2d 934 (Tex. 1988).
6. 378 S.W.2d 14 (Tex. 1964).
7. 889 S.W.2d at 683.

Because the parties were not partners, the court could not find a fiduciary relationship and the consequent duties unless it concluded that there existed a "special relationship between Brazosport and the borrower."[8] The borrower argued that such a relationship existed because of the link between the bank and partnership which the borrower said resulted from a previous relationship wherein a Brazosport director had once been a partner of the borrower. The court disagreed[9] and found that all pertinent provisions and relationships were fully disclosed to all partners at the time they chose to become partners.[10] No harm, no foul, whatever the theory.

Grimmett v. Higginbotham.[11]

In this partnership existence case the court cited *Coastal Plains Development Corp. v. Micrea, Inc.*, discussed above, in identifying the elements of a partnership.[12]

Although it is not unusual for one partner to provide capital and the other to provide services, other factors controlled here: in the absence of a written agreement defining a partnership relationship, and with the working partner receiving weekly compensation, and in the absence of an expressed agreement to share profits or losses, the appellate court had little difficulty overturning the trial judge's finding of a partnership. Instead, the court found an employer-employee relationship.

B. Limited Partner Liability

Humphreys v. Medical Towers, Ltd.[13]

The partnership issue[14] in this case involved a claim by the plaintiff that one of the defendants, Lawson, although expressly a limited partner in the defendant limited partnership, MTL, should have the liability of a general partner. The plaintiff's claim was that although Lawson was employed at MTL, he controlled all aspects of MTL's business. Further, the plaintiff *reasonably believed* that Lawson was the general partner of MTL—from what she could see, Lawson did not report to another per-

8. *Id.* Texas common law recognizes that "confidential relationships may arise not only from the technical fiduciary relationships such as attorney-client . . . partner and partner, etc.—which as a matter of law are relationships of trust and confidence—but may arise informally from 'moral, social, domestic or purely personal' relationships." *Thigpen v. Locke*, 363 S.W.2d 247, 253 (Tex. 1963).

9. The Court dismissed the line of cases cited by the plaintiff, finding that the cases would apply to an allegation that fiduciary duties had been breached, but could not be relied on to *find* a fiduciary relationship. 889 S.W.2d at 684.

10. *Id.* at 685.

11. 907 S.W.2d 1 (Tex. App.—Tyler 1995, writ denied).

12. *Id.* at 2. Curiously, and perhaps the most interesting thing about the case, the court cited the same elements in its analysis of whether there was a *partnership* as other cases have looked to in determining whether a "joint venture" exists. Established, if peculiar, Texas law injects the element of *sharing of losses* in determining the existence of a joint venture, but not necessarily in determining the existence of a partnership. Why that distinction was not observed here cannot be determined from the opinion.

13. 893 F. Supp. 672 (S.D. Tex. 1995).

14. The case dealt mostly with plaintiff's claims of employment-related torts allegedly committed by the defendant.

son, he had control of all aspects of MTL's business and he never referred to himself as a limited partner.[15]

The court cited the relevant provisions of the Texas Revised Limited Partnership Act ("TRLPA"):[16]

(1) A limited partner is not liable for the obligations of a limited partnership unless the limited partner is also a general partner or participates in the control of the business in addition to exercising its rights as a limited partner.[17]

(2) If a limited partner does participate in control, it is liable only to persons who transact business with the partnership who "reasonably believe," based on the limited partner's conduct, that the limited partner is a general partner.[18]

(3) A limited partner is not considered to participate in the control of the business by possessing certain rights or acting in certain capacities, including "acting as a contractor for or an agent or employee of the limited partnership or of a general partner, an officer, director, or stockholder of a corporate general partner, or a partner of a partnership that is a general partner of the limited partnership."[19]

The court concluded that there were enough fact issues on whether Lawson conducted himself as a general partner to preclude a summary judgment in his favor. It is difficult to predict what the court would have done if the procedural posture of the case had been other than a summary judgment proceeding. Presumably, the written limited partnership agreement did not take advantage of the TRLPA section 3.03(b) safe harbor provision to protect Lawson by defining his "hands-on" role.[20]

The plaintiff also argued that the corporate general partner of MTL was Lawson's *alter ego*, making him liable as general partner. To support that claim, plaintiff noted that Lawson was the corporation's sole shareholder, that the corporation was severely undercapitalized, that it derived all of its income from the operations of MTL and paid a number of Lawson's personal expenses. In the summary judgment context, the court again found enough fact issues to preclude summary judgment for defendant Lawson.[21]

C. Fiduciary Duty

A long-standing hallmark of the partnership relationship is the existence of fiduciary duties. The statutory support for the existence of fiduci-

15. 893 F. Supp. at 689.

16. Tex. Rev. Civ. Stat. Ann. art. 6132a-1 (Vernon Supp. 1996) [hereinafter TRLPA].

17. TRLPA § 3.03(a).

18. TRLPA § 3.03(a).

19. TRLPA § 3.03(b)(1); 893 F. Supp. at 688.

20. Section 3.03(b)(8)(K) gives a limited partner a safe harbor from liability as a general partner for proposing, approving, disapproving, by vote or otherwise, any matters *stated in the partnership agreement.*

21. 893 F. Supp. at 689.

ary duties is more cryptic than explicit. The Texas Uniform Partnership Act's ("TUPA") only use of the term is in the *caption* of Section 21, which obligates every partner to account to the partnership for any benefit, and hold as trustee any profits derived by the partner without the consent of the other partners, from any transaction connected with formation, conduct or liquidation of the partnership.[22] Nevertheless, Texas common law is well-established that strong fiduciary duties are owed by general partners to each other, to their partnership and to limited partners.[23]

In the general partnership context, the Texas legislature acted to change this fiduciary framework in 1993, when it implemented the Texas Revised Partnership Act[24] ("TRPA"), which became effective January 1, 1994 for partnerships created after December 31, 1993 (and for pre-existing partnerships that elected to be governed by the TRPA). TRPA section 4.04 defines the "general standards of a partner's conduct" in terms of a partner's duties owed to the partnership and the other partners to be: (i) a *duty of loyalty*, and (ii) a *duty of care*. Section 4.04(f) states that a partner is *not* a *trustee* and is *not held* to the *same standard as a trustee*. This provision intends to align the statutory duties with modern expectations—the statutory narrowing of these duties recognizes that partnerships are, for tax purposes, used in business settings in which corporations might have been used in the past, and the duties of owners/managers should be comparable. The partnership committee bill analysis of the statute clearly states that elimination from the statute of reference to the term "fiduciary" was intended and that movement toward a "business judgment rule" standard between general partners was intended.[25] It appears from the next case that the Supreme Court of Texas did not get that message.

M. R. Champion, Inc. v. Mizell.[26]

This was a *per curiam* opinion, replacing the prior opinion of the Texas Supreme Court. The case involved a dispute between two former partners in which the dispositive issue was whether the trial court correctly construed the jury verdict. The court of appeals held that the trial court did not, but the Supreme Court disagreed (at least on rehearing).[27]

The opinion in this case is somewhat unfulfilling—on the one hand, for a very short opinion, there is a lot of substance packed into it; on the other hand, important questions are left unanswered and key legal concepts are confused. A chronology of events will frame the discussion:

22. TEX. REV. CIV. STAT. ANN. art. 6132b, § 21 (Vernon Supp. 1995) (entitled "Partner Accountable as a Fiduciary" [hereinafter TUPA]).

23. *See, e.g.*, Huffington v. Upchurch, 532 S.W.2d (Tex. 1976); Johnson v. Peckham, 132 Tex. 148, 120 S.W.2d 786 (1938).

24. TEX. REV. CIV. STAT. ANN. art. 6132b-1-1.01-.06 (Vernon Supp. 1995) [hereinafter TRPA].

25. TEX. REV. CIV. STAT. ANN. art. 61326 cmt. (Vernon Supp. 1996) [hereinafter Partnership Committee Comments].

26. 904 S.W.2d 617 (Tex. 1995).

27. *Id.*

1/86 - Mizell and Champion, as partners, contracted to provide services to Northwestern Resources.[28]

12/86 - Champion negotiated a second one-year contract with Northwestern under the name M.R. Champion, Inc., but assured Mizell that they would still be partners.[29]

1/87 - Northwestern barred Mizell from its premises for taking some of its property; Champion worked for Northwestern during 1987, using equipment leased from Mizell.[30]

12/87 - Champion negotiated a three-year contract with Northwestern.[31]

1/88 - Champion told Mizell the partnership was over.[32]

The only claim, of a number that Mizell asserted, on which the case was tried was that Champion breached his fiduciary duty by not obtaining the three-year contract with Northwestern for the benefit of the Mizell-Champion partnership.[33]

The Supreme Court primarily evaluated the court of appeals' analysis of the trial court's determination of the legal effect of the jury's findings. Champion contended that the partnership "*terminated*" in January 1987 because of Mizell's misconduct toward their partnership's customer, Northwestern, and therefore Champion had no duty to refer new business opportunities (namely, the three-year contract) to the partnership. Mizell asserted that the partnership was not "*dissolved*" until Champion stated that the partnership was "over" in January 1988, which allegedly resulted in Champion breaching a continuing fiduciary duty when he obtained the three-year contract. (The court's use of the terms "terminated" and "dissolved," apparently interchangeably, is a frustrating example of a long-term failure of courts and practitioners to make the important distinction between the two concepts.)[34]

The jury's findings included: (i) that Champion breached his fiduciary duty to Mizell and to the partnership (the jury was not asked to find *when* that breach occurred), and (ii) that after Mizell was barred from Northwestern's premises in January 1987, he breached the partnership agreement and was guilty of conduct that made it "not reasonably practicable to carry on partnership business."[35]

The trial court concluded, based on this latter finding (which intends to invoke TUPA section 32(1)(d), which allows judicial dissolution when a partner's conduct makes it not reasonably practicable to carry on busi-

28. *Id.* at 617-18.
29. *Id.* at 618.
30. *Id.*
31. 904 S.W. 2d at 618.
32. *Id.*
33. *Id.*
34. *Dissolution* is a change in the relationship of the partners, usually caused by a partner's separation from the partnership, while *termination* is the end of the partnership's legal existence. BLACK'S LAW DICTIONARY 473, 1471 (6th ed. 1990).
35. 904 S.W.2d at 618.

ness with him),[36] that the partnership "terminated" in January 1987, which was before the breach of fiduciary duty claimed by Mizell (remember, his complaint centered on the three-year contract that was not struck until late 1987).

The trial court found for the defendants, but the court of appeals reversed and rendered in favor of Mizell, reasoning that the jury's finding that Champion breached his fiduciary duty necessarily included the finding that the partnership continued through December 1987, when the only damages claimed by Mizell occurred.[37] The Texas Supreme Court said that the court of appeals was incorrect because whether Champion still had a duty to Mizell in December 1987 was a *legal* determination for the court, not a *factual* determination for the jury. The legal determination, the court said, could be made based on the jury's finding regarding Mizell's improper conduct in January 1987, coupled with the trial court's finding that the partnership terminated. In the court's words: "The jury's finding that Champion breached his fiduciary duty does not control the legal determination of whether such duty existed; the finding concerning Mizell's conduct does."[38]

Among the noteworthy aspects of this case are the following:

(1) Although the case was tried under and governed by the TUPA, (article 6132b) and not by the TRPA, which became effective January 1, 1994 for partnerships formed after December 31, 1993 (or that elected to become subject to the new statute), the court held that the principles that applied to this case were the same under both statutes. In following that thought, the court cited TRPA sections 4.04 and 4.05 for the following proposition: "Partners owe each other and their partnership a duty *in the nature of a fiduciary duty* in the conduct and winding up of partnership business, and are liable for a breach of that duty."[39] (Emphasis added) *In one stroke of its pen, the Court may have undone the effort of the Texas Legislature to remove fiduciary duty, as such, from the general partnership act.*[40]

(2) After citing to the new TRPA, the court (almost as if trying to identify authorities as chronologically remote to each other as possible) cited *Rice v. Angell*[41] for the proposition that after a partnership *terminates*, a partner's duty is limited to matters relating to the winding up of the partnership's affairs. In particular, the court said that that person has no duty to offer to his former partners a business opportunity that arises after the partnership is terminated. The last statement is true enough, but the court's earlier reference to "winding up" after "termination" (rather

36. Again, the court chose the comparable provision of the new, but technically inapplicable TRPA, by referring to TRPA § 6.01. *Id.*

37. *Id.*

38. *Id.* at 619.

39. *Id.* at 618.

40. *See* Partnership Committee Comments, *supra* note 25.

41. 73 Tex. 350, 11 S.W. 338 (1889).

than after "dissolution") is unfortunate.[42]

(3) The court made no effort to distinguish among the concepts "dissolution," "winding up" and "termination." In fact, the court refers to "winding up" occurring after "termination." The progression under the TUPA is: *Dissolution . . . Winding Up . . . Termination.*[43]

Fiduciary duties exist after dissolution and during winding up, but not after termination (which ends the legal existence of the partnership after winding up occurs to settle accounts with creditors and among partners). It is important to maintain the distinction between dissolution and termination, and the court's failure to do so is disappointing (and, one might assume, partly a result of the lawyers' failure to make the distinction).[44]

D. PROCEDURE—DIVERSITY JURISDICTION

Bankston v. Burch[45]

This was a suit by a limited partner (a Texas citizen) against a general partner (a California citizen). The issue in the case was whether a limited partnership is an "indispensable" party for diversity jurisdiction purposes, where the suit is "derivative" in nature. For diversity jurisdiction purposes (under *Carden v. Arkoma Associates*[46]) a partnership is considered a citizen of every state in which a general *or* limited partner is a citizen, meaning that the limited partnership here was a citizen of both Texas and California.[47] Plaintiff sued defendant (in his individual capacity, not as a representative of the partnership) in state court, without joining the limited partnership, for fraud and negligent misrepresentation with respect to the limited partnership. Defendant removed the case to federal court, and then on the eve of trial filed a motion to dismiss, claiming that plaintiff had failed to join the limited partnership and the limited partners as "indispensable parties" under Fed. R. Civ. Proc. 19. The district court nevertheless proceeded to trial, and the jury held for plaintiff on some claims. Plaintiff then filed a motion for j.n.o.v. for the claims that were denied and acknowledged that some of his claims against defendant were "derivative" in nature. Eventually, the district court entered judgment against defendant and defendant appealed, claiming that the district court

42. This is not a proper use of the term "terminates." Under well-established law, partners owe duties to one another after dissolution through winding up until termination. (*See, e.g.*, TUPA § 30: "On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed.") After termination, there are no further duties owed.

43. TUPA § 30.

44. The TRPA eliminates the term "dissolution" and some of the difficulties that it has presented, as exemplified above. Instead, the TRPA speaks of "*events of withdrawal*" (of a partner) and "*events that require a winding up*" (of the partnership). At least in partnerships with more than two partners, the bias of the TRPA favors continuation, not winding up, but includes a statutory mechanism to deal with the partner who suffered an event of withdrawal (through a "redemption" or buy out of the withdrawn partner's interest in the partnership). *See, e.g.*, TRPA § 7.01.

45. 27 F.3d 164 (5th Cir. 1994).

46. 494 U.S. 185 (1990).

47. 27 F.3d at 169.

had no subject matter jurisdiction to enter judgment on a derivative claim.[48]

The court noted that limited partners can, if permitted by statute, sue "derivatively" to enforce rights belonging to the partnership; because the partnership possesses the rights to be enforced, it is, at a minimum, the real party in interest in a derivative lawsuit.[49]

The court held that the limited partnership was "even more than the real party in interest—it is an indispensable party without whom the lawsuit should not have gone forward."[50] The court then listed the following four factors from Federal Rule 19(b) as relevant to the determination of whether a party is indispensable: (1) the extent to which a judgment rendered in the party's absence might be prejudicial to that party or others in the lawsuit; (2) the extent to which, by protective provisions in the judgment, by the shaping of relief, or other measures, the prejudice can be lessened or avoided; (3) whether a judgment rendered in the party's absence will be adequate; and (4) whether the plaintiff will have an adequate remedy if the party cannot be joined.[51] The court held that these factors, particularly that a judgment will prejudice the partnership's rights and that shaping the relief provided inadequate protection to the partnership's interest, favored holding that the limited partnership *was* an indispensable party.[52]

The court noted that under *Carden* the citizenship of all partners, limited as well as general, controls the citizenship of the limited partnership itself, *even if* this results in there never being diversity jurisdiction in a suit by a partner against the partnership. Applying *Carden*, the court held that because the plaintiff was a citizen of Texas and the limited partnership (also a Texas citizen via plaintiff) was an indispensable party defendant for Plaintiff's derivative claim, there was no complete diversity of citizenship.[53]

The court made it clear that one cannot manufacture diversity jurisdiction by failing to join a non-diverse, but indispensable, party.[54] Here, that indispensable party was the partnership, based on the derivative nature of the claims being asserted. The court admitted that its refusal to carve exceptions from *Carden* "effectively closes the doors of the federal courts to many lawsuits among partners or by partners against a partnership."[55]

Mallia v. PaineWebber Incorporated[56]

This case involved, in a slightly different setting, the same basic issue as *Bankston v. Burch* in the context of a fraud suit by limited partners

48. *Id.* at 166-67.
49. The Texas Revised Limited Partnership Act expressly allows derivative suits. *See* TRLPA § 10.
50. 27 F.3d at 167.
51. *Id.* at 168.
52. *Id.*
53. *Id.*
54. *Id.*
55. 27 F.3d at 168-69.
56. 889 F. Supp. 277 (S.D. Tex. 1995).

against the sellers of their limited partnership units—what is the effect, under *Carden*, on a determination of complete diversity of the presence (or absence) of the limited partnership in the suit?

Plaintiffs bought partnership units in two limited partnerships, and sued the defendants (who included the limited partnerships) for securities fraud, saying that this investment was unsuitable for them and that they were induced to purchase units by the defendants' fraudulent misrepresentations and omissions.[57] Plaintiffs brought suit in state court, and defendants removed to federal court. Plaintiffs claimed that the case must be returned to state court for a lack of complete diversity that resulted from the limited partnerships' being Texas residents, under *Carden*.

The court discussed the *Carden* rule, covered in detail *supra*, that a limited partnership must be counted as a resident, for diversity jurisdiction purposes, of every state in where each limited partner resides. Thus, the court found that *Carden* would preclude diversity jurisdiction here. But, that did not end the matter—the court said that it had to consider *subject matter jurisdiction*, and determine the *nature* of the *claims*.[58]

The Court noted that there were no Fifth Circuit opinions that involved *non-derivative* limited partner claims, and in a footnote, stated that "several comments by the Fifth Circuit strongly suggest that it will follow other courts in making this distinction," and cited *Bankston* (noting that in *Bankston* the Fifth Circuit "followed *Carden* by specifying that the facts before it were specifically limited to derivative claims").[59] The court then said: "the "overwhelming development of judicial opinions in the post-*Carden* environment clearly indicates that courts are not willing to follow *Carden's* directive when a plaintiff's claims are of a direct, rather than a derivative, nature."[60] The court said that well-settled law allowed a limited partner to pursue one of three types of claims against the general partners of the limited partnership for alleged breaches of fiduciary duties or other wrongdoings: (1) an individual, direct claim; (2) a direct claim against the general partners through a representative action, such as a class action lawsuit; or (3) a derivative suit on behalf of the partnership itself.[61]

Therefore, because the Plaintiff's suit was "direct" instead of "derivative," the court held that the *Carden* rule did not apply, and overruled plaintiff's motion to remand the case to state court. The court stated that its reading of relevant case law after *Carden* strongly suggests that when a plaintiff's claims are direct in nature (particularly when they are brought, as here, as a *class action*) the limited partnership will not be considered an indispensable party under Federal Rule 19, and will not be considered

57. *Id.* at 279.
58. *Id.* at 281.
59. *Id.* at 281 n.2.
60. *Id.* at 281.
61. 889 F. Supp. at 281 (citing Lenz v. Associates Inns and Restaurants Co. of Am., 833 F. Supp. 362, 378 (S.D.N.Y. 1993); Curley v. Brignoli, Curley & Roberts Assoc., 915 F.2d 81 (2d Cir. 1990), *cert. denied*, 499 U.S. 955 (1991)).

in a court's analysis of diversity jurisdiction. Rather, the court held that the limited partnerships were merely "nominal" rather than "indispensable" parties, and overruled the motion for remand.[62] The court did, however, note the existence of class action litigation involving the same partnerships in New York, and ordered the parties to respond to its *sua sponte* motion to consolidate the case with that class action litigation.[63]

Bankston and *Mallia* can be reconciled as follows: Where a partner (limited or general) sues another partner or third party (and the partnership is joined as a defendant), whether *Carden* can be used to defeat diversity jurisdiction (i.e., no complete diversity) depends on the nature of the suit—if it is "derivative," it can, and if "direct," it cannot.

E. Authority of Partner

FDIC v. Enventure[64]

This summary judgment case involved an attempt by non-signatory general partners of a limited partnership, in an FDIC suit on a promissory note, to avoid liability for the partnership's note debt based on a lack of authority of the solitary signatory general partner to bind the partnership.

The FDIC (plaintiff) was appointed receiver of a bank in 1987, and filed suit in 1993 against Enventure (a limited partnership) and Horton and Daniels (general partners of Enventure). The FDIC sued to collect on a promissory note executed by Chambers, another general partner of Enventure, in 1986. Defendants claimed that Chambers was not authorized to execute the note on behalf of Enventure. The court granted summary judgment in favor of the FDIC.[65]

The court began its analysis by noting that "[u]nder Section 10 of the Texas Uniform Limited Partnership Act, in effect at the time of these transactions, a general partner of a limited partnership has all of the rights and powers and is subject to all of the restrictions and liabilities of a partner without limited partners."[66] This led the court to Section 9 of the TUPA, which provides that

> [e]very partner is an agent of the partnership for the purposes of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.[67]

Therefore, the court concluded, the partnership was bound by the general partner's execution of the note, *unless* Chambers had no authority to

62. 889 F.2d at 283.
63. *Id.* at 283-84.
64. 868 F. Supp. 870 (S.D. Tex. 1994).
65. *Id.* at 873.
66. *Id.* at 874.
67. *Id.*

execute the note on behalf of the limited partnership *and* the bank, *and the FDIC* had knowledge of that lack of authority.[68]

The defendants' first claimed that their partnership agreement, which apparently was in the possession of the bank (although the defendants failed to prove this in the litigation) did not authorize Chambers alone to execute the note, because it required all four general partners to act collectively to bind the partnership. Therefore, they argued, the note was unenforceable against the partnership (and them, the other general partners). That was probably all true. However, the FDIC provided sufficient summary judgment evidence to support its claim that the partnership agreement was *not* in its possession, and the court held that under Texas law the FDIC did not have the requisite knowledge of Chambers' lack of authority.[69]

Adding insult to injury, the court also found that the *D'Oench* doctrine (from *D'Oench, Duhme & Co. v. FDIC*[70]), and its so-called codification,[71] were independently sufficient to defeat the defendants' claim. The *D'Oench* doctrine (1) bars defenses or claims against federal regulators where a financial institution enters into an oral or a so-called "secret" agreement with a borrower that alters the terms of an existing unqualified obligation, and (2) precludes enforcement of any defense or claim upon a written agreement that is not found within the financial institution's records covering the financial transactions at issue.[72]

Even if the partnership agreement had been in the files of the FDIC, the court found that the agreement still would "run afoul" of 12 U.S.C. § 1823(e) (the codification of the *D'Oench* doctrine). Section 1823(e) allows the FDIC to avoid any agreement that diminishes the FDIC's interest in any asset acquired by it as a receiver unless the agreement: "(1) is in *writing*; (2) was *executed* by the depository institution and the obligor *contemporaneously* with the acquisition of the asset by the institution; (3) was approved by the depository institution's board of directors or its loan committee. . .; and (4) has been continuously an official record of the depository institution."[73] The court found that the partnership agreement "clearly did not meet the parameters of § 1823(e)," and could therefore not be used as a defense to the FDIC's claims, because (1) it was neither executed by the bank nor approved by the bank's board or loan committee; and (2) it was not executed by Enventure's general partners "contemporaneously" with the note (it was executed four years before the note was executed).[74] This was one circumstance where, to be fair, the bank's failure to exercise due diligence probably *should not* have been held against the FDIC. There are, of course, dozens of other cases

68. *Id.*
69. 868 F. Supp. at 875.
70. 315 U.S. 447 (1942).
71. 12 U.S.C. § 1823(e) (1989).
72. 868 F. Supp. at 875.
73. *Id.*
74. *Id.*

where *D'Oench* or section 1823(e) have served to frustrate a borrower's reasonable expectations.

The case also involved some interesting guaranty issues. The court denied the defendants' guaranty defenses and then, for good measure, denied their statute of limitations argument (after all, the FDIC beat the expanded 6-year statute's deadline by a good 1 minute, 20 seconds!).[75]

F. Partnership Agreement Controls Relationship

B&R Communications v. Lopez[76]

In this case, the minority partners (plaintiffs) sued the 68% majority partner (defendant) alleging material breaches of and defaults under the partnership agreement, including the use of partnership funds to engage in predatory litigation (resulting in large legal expenses to the plaintiff's pecuniary disadvantage). During discovery, plaintiffs sought records of all litigation commenced or threatened by defendant. Defendant furnished all records except the correspondence and files of the partnership's attorney relating to pending litigation (one of which involved a case presently on appeal in which defendant won a big judgment). The trial judge allowed defendant to withhold certain items and plaintiffs initiated this mandamus proceeding to compel production.[77]

The partnership agreement limited the right of inspection in *only* two ways: (1) inspection must be done at reasonable times and during business hours only, and (2) inspection must not "unreasonably interfere" with the partnership's operation.[78] The court held that the agreed, contractual standard rendered the discovery requirement of "relevancy" inapplicable to plaintiffs' request to inspect the records. The court also held that the fact that partners placed the complete and exclusive power to conduct the partnership's affairs in the executive committee was irrelevant to the plaintiffs' request for the records because they were merely asking to inspect records, not trying to conduct the business of the partnership.[79]

The court struck down defendant's "global" claim that giving the records to the plaintiffs would "unreasonably interfere" with the partnership's operations (defendant argued that turning over the records could hurt the partnership's chances of retaining its judgment in the case on appeal), because defendant made no showing that this was true.[80] The court also held that the fact that the partners contracted in the partnership agreement not to disclose or make available "confidential" information of the partnership without the consent of the partnership's executive committee, did not limit plaintiffs' right to examine and inspect the part-

75. *Id.* at 877.
76. 890 S.W.2d 224 (Tex. App.—Amarillo 1994, no writ).
77. *Id.* at 226.
78. *Id.*
79. *Id.* at 228.
80. *Id.*

nership records, and thus did not preclude examination of this "confidential" information.[81] Without stating directly, the court clearly felt that the limitations contained in the partnership agreement were intended to preclude disclosure *to third parties* of confidential partnership information. Therefore, even though the defendant apparently did not trust the plaintiffs' use of confidential information, the contract expressed in the partnership agreement did not allow the defendant to withhold the information here.

Finally, the court held that because a protective order was in place preventing disclosure of proprietary information, the alleged proprietary nature of the requested records did not preclude plaintiffs from examining the records, despite defendant's claim that the plaintiffs (who were also active in the partnership's area of business) might use the information requested to their advantage and to the partnership's detriment.[82]

G. Tax Matters Partner

Medical & Business Facilities Ltd. v. Commissioner Of Internal Revenue[83]

The question in this appeal of a tax court finding in favor of the Internal Revenue Service was whether a general partner (who is not the tax matters partner ("TMP")[84] has either actual or apparent authority to execute, in favor of the IRS, consents extending the period of limitations.

Here, a partnership filed a protest contesting that income tax adjustments were barred by limitations. Brooks, one of the general partners who was *not* the TMP of the partnership, signed several consents extending the period of limitations (the "Consents") despite not being authorized in writing by the partnership.[85] The Internal Revenue Code provides that the limitations period may be extended by an agreement signed by a partnership's tax matters partner or "any other person authorized by the partnership *in writing* to enter into such an agreement."[86] (Emphasis added). Therefore, because Brooks was not the TMP and was not authorized in writing to sign the Consents, the Fifth Circuit, reversing the United States Tax Court, held that the Consents were invalid.[87]

The court of appeals noted that partnership agreements (because they are "in writing") have been held to provide general partners with actual authority to execute documents like the Consents where those agreements expressly granted the general partners broad authority to act for the partnership.[88] The court then held that the partnership agreement here did not contain such a broad grant of authority to any individual partner, because it required collective decision-making that included the

81. 890 S.W. 2d at 228-29.
82. *Id.* at 229.
83. 60 F.3d 207 (5th Cir. 1995).
84. I.R.C. § 6231(a)(7) (1986).
85. 60 F.3d at 209.
86. I.R.C. § 6229(b)(1)(B).
87. 60 F.3d at 212.
88. *Id.* at 210.

other general partners. Therefore, the Consents were not valid.[89] To summarize, the Fifth Circuit held that: (1) the partnership agreement did not give the general partner actual authority to execute Consents to extend the limitations period applicable to the partnership; (2) the general partner did not have apparent authority to execute Consents to extend the period of limitations; and (3) because designation of a partner as the partnership's tax matters partner must be filed with the I.R.S., the I.R.S. cannot reasonably rely on a representation of one of several general partners as to his status as tax matters partner.

III. LEGISLATION

As noted in the Introduction above, the Texas Business Law Foundation included in its 1995 legislative package a "Business Organizations Bill," that amended portions of several business organization statutes, including the Texas Business Corporation Act, the Texas Limited Liability Company Act, the Texas Revised Limited Partnership Act and the Texas Revised Partnership Act.[90] As noted, politics intervened and the legislation was not passed. But, because the legislation will be re-introduced in 1997, it might be useful to identify the most important partnership statute changes.

A. LIMITED PARTNERSHIPS

Among the changes proposed to the TRLPA are the following:

1. *Conversions.* Each of the four statutes listed above will be amended to include a "conversion" right that will allow any corporation, limited liability company, limited partnership or general partnership to convert into any of the other forms by following a relatively simple procedure of filing a plan of conversion.[91] Amendments are being made to each statute to accommodate that concept.

2. *LLC Membership.* Section 3.03(b)(1) of the TRLPA is proposed to be amended to clarify that acting as a member or manager of an LLC or in a similar capacity with another person that is a general partner, does not constitute taking part in control of the business of a limited partnership (comparable to acting as officer or director of a corporate general partner).[92]

3. *Limited Partner Withdrawal Right.* Section 6.03 of the TRLPA is proposed to be amended to reverse the statutory presumption that a limited partner may withdraw on 6 month's notice.[93] Partners could still grant a limited partner the right to withdraw in the partnership agreement. The presumption was contrary to most parties' expectations and

89. *Id.*
90. H.B. 1425, 74th Leg., C.S. (1995).
91. *Id.* § 20.
92. *Id.* § 92.
93. *Id.* § 93.

caused problems in the family limited partnership area (a "lapsed right/valuation" issue).

4. *Continuation Without Dissolution on General Partner Withdrawal.* The TRLPA currently provides that a limited partnership dissolves when a general partner ceases to be a general partner, but allows reconstitution in certain cases in which there is at least one other general partner, or another is appointed.[94] This is proposed to be amended to conform to the TRPA provisions on dissolution by providing that a limited partnership may continue *without dissolution* if at least one other general partner remains or is appointed.[95]

B. General Partnerships

Among the changes proposed to the TRPA are the following:

1. *Conversion.* The same type of conversion provisions added to the other business organization statutes are added here.

2. *Registered Limited Liability Partnership.* Sections 3.05 and 3.08 would be amended to make explicit the specific limitation on liability provided to partners in registered limited liability partnerships in certain cases.[96] This provision overrides more general provisions creating liability for partners in requiring them to share losses through a contribution obligation. Also, Section 8.06 would be amended to make explicit that a partner who is not liable for a partnership debt or obligation (whether by agreement of the creditor or because the partnership is a registered limited liability partnership) is not required to contribute funds to enable the partnership to pay those obligations or to reimburse liable partners who have paid them.[97] This result is implicit under existing law, but is being clarified. Similar changes were made to the federal Bankruptcy Code in Chapter 7 liquidations.

94. TRLPA § 8.01.
95. H.B. 1425 § 94.
96. *Id.* §§ 105-106.
97. *Id.* § 112.