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Partnerships

Steven A. Waters

Berkley P. Berkley

PARTNERSHIPS

by

Steven A. Waters and Florence P. Berkley***

TEXAS cases in the partnership area are as plentiful this year as they were scarce last year.[1] For the reader's convenience, the cases are grouped under topical headings corresponding to the most important *partnership* feature of the case. This survey provides a reasonably complete overview of Texas partnership law activity for the survey period. The reader is cautioned, however, that federal bankruptcy court opinions provide a fertile ground for the discussion of partnership law issues arising from the bankruptcy of a partner or partnership. These decisions often produce valuable insights into partnership law issues. In addition, they highlight the interplay between partnership law and bankruptcy law.

1. PLEDGE OF PARTNERSHIP INTEREST

Thomas v. Price.[2] The opening paragraph of *Thomas*, the most significant and controversial case reported in this survey, suggested that this would not be a run of the mill case:

> This case was filed on May 9, 1986,[3] and has floundered ever since on the docket of this Court. The parties are interminably mired in an acrimonious confrontation that involves issues of first impression in Texas jurisprudence. In an attempt to refocus this litigation, the Court ordered the parties to rebrief the Price defendants' second motion for summary judgment. The Court also had the parties brief some additional matters. The Court has reviewed the briefs of the parties and will now apply its interpretation of Texas law to the facts so that this entire case can be put into perspective and this litigation concluded.[4]

The issues in *Thomas*, which were of first impression in Texas, concerned

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

** B.M., M.F.A., J.D., University of Texas. Attorney at Law, Haynes and Boone, Austin, Texas.

1. *See* Gray, Vletas, & Waters, *Corporation and Partnerships, Annual Survey of Texas Law*, 43 Sw. L.J. 221, 251-56 (1989).

2. 718 F. Supp. 598 (S.D. Tex. 1989).

3. The case began even earlier in the state of New York: *Thomas v. Price*, 631 F. Supp. 114 (S.D. N.Y. 1986).

4. 718 F. Supp. at 600. Other statements by the court indicated that the court was not favorably disposed toward the plaintiff (SLT): "The plaintiff doggedly persisted in trying to discover every document that could possibly be associated with the case. The end result was to delay disposition . . . . '[T]he court thought it important that certain legal issues be addressed before allowing the plaintiff to further muddy the turbid waters of this litigation." *Id.* at 604. The plaintiff also sought, unsuccessfully, to recuse the court. *Id.*

the consequences to a partner and partnership of the partner's pledging as security for a loan his interest in the profits and surplus, and management, of a partnership.[5] The court termed those consequences "serious," concluding that on the partner's default under the security agreement: (1) the secured creditor acquired an immediate right to receive the debtor partner's interest in profits and surplus; (2) the secured creditor acquired the debtor partner's management rights, although the secured creditor could not exercise those rights without the consent of the remaining partner; (3) the debtor partner ceased to be a partner in the partnership; and (4) there was a dissolution of the partnership.[6]

The relevant facts of the case for purposes of this discussion include the following:

(1) Plaintiff SLT, a partner in a two-partner partnership, borrowed $750,000 from Newcomb (an affiliate of the other partner) to fund certain of SLT's capital contributions to the partnership. The loan was non-recourse and was secured by a security interest in SLT's " 'right, title and interest in its interest in the Partnership, as such interest is defined by Section 26 of the Uniform Partnership Act of the State of Texas'," and in SLT's share of proceeds attributable to its interest in the partnership.[7] The security agreement provided that Newcomb (the secured party) had no right to interfere in the management of the partnership in the absence of a default.

(2) SLT defaulted by not paying its note at maturity and was advised on November 26, 1985 by the secured party (Newcomb's assignee) that the pledged partnership interest would be retained in full satisfaction of SLT's $750,000 note, unless SLT objected within 21 days, in which case the collateral would be sold at a private or public sale under Section 9-505(b) of the Texas Business and Commerce Code.

(3) SLT objected to disposition under section 9-505(b) and insisted on disposition at a sale under section 9-504, and by letter dated December 20, the secured party notified SLT that a private sale would take place on or after January 8.

(4) To preserve the collateral (according to the secured party), the secured party removed SLT's affiliates from the management committee of the bank owned by the partnership and replaced them with the secured party's nominees. The other partner authorized the nominees to exercise the management rights.

(5) After a series of letters were exchanged, meetings held, and lawsuits filed in New York and Texas, on September 10, 1986, the secured party sold the partnership interest in a private sale to an affiliate of the secured party. In the words of the court, "[o]ver the next twenty-five months, the case fol-

5. *Id.* at 605. The court asked whether the partner's loss of management rights caused a dissolution, and what liability the partner had to third parties for actions taken by the partnership after the partner lost its management rights.

6. *Id.* at 612.

7. *Id.* at 601.

lowed a tortuous path."[8]

The court began by examining the elements or incidents of a partnership interest under Texas law.[9] It identified three factors: (1) the sharing of profits and losses; (2) the participation in the control of the management of the partnership; and (3) the interest, as a tenant in partnership, in specific partnership property. The court found the control element to be the most significant criterion, and found the first two elements, but not the third, to be assignable under Texas law.[10]

These elements were important to the court's conclusions. The court found that under the SLT-Newcomb security agreement, SLT immediately lost its interest in profits and surplus and its management rights when it defaulted in paying its note, but concluded that the secured party was not automatically entitled to exercise those management rights.[11] The court found that before the security interest in the partnership interest was foreclosed, SLT lost all of its incidents of partnership and, therefore, partnership status.[12] When the other partner allowed the secured party to participate in management after SLT's default, the secured party became a partner.[13] The court concluded that SLT ceased to be a partner when it defaulted, but that it could become a partner again before foreclosure by redeeming its interest in the partnership by paying the amount due on its debt. Foreclosure cut off that right of redemption.[14]

The court further concluded that when SLT lost its status as a partner, dissolution of the partnership occurred.[15] Additionally, the court said that the foreclosure resulted in a dissolution of the partnership, which had no effect on the sole remaining partner's ability to continue the business of the partnership.[16] The court's pronouncement of the partnership's dissolution is

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8. *Id.* at 604.

9. *Id.* at 605. The court said that to determine whether SLT ceased to be a *partner* required an examination of what constitutes a *partnership*.

10. *Id.* It is not customary to refer to the management right as being assignable because it cannot be assigned without the agreement of the other partners. TEX. REV. CIV. STAT. ANN. art. 6132b, § 27(1) (Vernon 1970).

11. 718 F. Supp. at 606. The New York court's position is at odds with the Texas court's conclusion on management rights. 631 F. Supp. at 124. The New York court stated that on SLT's default, the secured party "was entitled . . . to take possession of the collateral . . . and then to participate directly in 'the management, administration, affairs and control' of the Bank Partnership." *Id.*

12. 718 F. Supp. at 607, n. 67. The court's discussion here proves curious.

13. *Id.* at 608.

14. *Id.* at 607, n. 67.

15. *Id.* at 607.

16. *Id.* at 608. Without suggesting that the court was wrong to conclude that one person could continue the partnership's business as a newly constituted partnership pending the admission of a second partner, it seems somewhat anomalous that the court was so very quick to conclude that SLT lost its partnership status *immediately* on a default, and then to find that the other partner could, alone, form a new partnership to continue the business, and invoke as partial authority for that position a case that states that the remaining *partners* can continue the business of a dissolved partnership. The partnership act clearly states that a partnership consists of two or more persons. TEX. REV. CIV. STAT. ANN. art. 6132b, § 6(1) (Vernon 1970). The court bootstrapped its position, admitting that it gave no significance to the plural term "partners," by pointing to the fact that a partnership is an entity distinct from its partners. 718 F. Supp. at 608, note 75.

indicative of its confusion:

> Regardless of whether the secured party obtains the right to participate in the management of the partnership, the debtor ceases to be a partner because the criteria that creates a partnership must continually exist. Accordingly, there is a dissolution because there is a change in the relation of the partners.[17]

This confuses cause and effect. The debtor does not cease to be a partner because the criteria that create a *partnership* do not exist; surely, the court meant that the debtor's loss of incidents of ownership of a partnership interest resulted in its not being a partner, which, in turn, resulted in dissolution.

The court further found that the winding up required pursuant to Sections 29 and 30 of the Texas Uniform Partnership Act is limited to paying off the former partner.[18] Here, the court reasoned that no payment was required to be made to the former partner for its interest in partnership property because that was not a "financial interest," and the partner's interest in profits and surplus had already passed to the secured party.[19]

Resolution of the liability issue flowed relatively naturally from the court's other decisions on partner status. The court held that SLT was liable for debts that arose before November 26, the default notice date as of which the court found that SLT ceased to be a partner, but not for liabilities arising after that date.[20] Consistent with its position that the secured party became a partner on the date that it was authorized by the remaining partner to exercise management rights, the court found that the secured party was liable as a partner from the date on which its management nominees were authorized to exercise the management rights of SLT (December 20), rather than from the date ten months later when the foreclosure sale was conducted.[21]

In summary, the court concluded, among other things, the following:

1. On default, the secured creditor receives an immediate right to receive SLT's interest in profits and surplus;

2. Also on default, the secured party obtains SLT's management rights, but has no right to interfere in the management of the partnership without the consent of the remaining partner;

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17. *Id.* at 612.

18. 718 F. Supp at 608.

19. *Id.* at 609. Cutting off SLT's liability at the moment dissolution occurred, and making the debtor liable only for pre-existing obligations of the partnership at that point, was not necessarily correct. The Texas Uniform Partnership Act provides that after dissolution a partner can bind the partnership by "any act appropriate for winding up partnership affairs or completing transactions unfinished at dissolution," or by "any transaction which would bind the partnership if dissolution had not taken place," provided that the creditor previously extended credit to the partnership and had no knowledge or notice of the dissolution or that a creditor that had not previously extended credit had nevertheless known of the partnership prior to dissolution and the notice of dissolution had not been advertised in a newspaper of general circulation. TEX. REV. CIV. STAT. ANN. art. 6132b, § 35(1)(a) and (b) (Vernon 1970). It is possible that the post-dissolution liabilities were outside these categories, but the court did not appear to base its position on that.

20. 718 F. Supp. at 609.

21. *Id.* at 610.

3. Regardless of whether the secured creditor receives the right to participate in management, SLT ceases to be a partner because the criteria that create the partnership ceased to exist;

4. Because SLT ceased to be a partner, there was a change in the relationship of the partners and, consequently, a dissolution of the partnership;

5. The remaining partner may continue the partnership and winding up is required only to the limited extent of paying off SLT, but under the present facts no winding up is required because SLT is not entitled to any compensation, since the financial interest in the partnership property had already passed to the secured party;

6. SLT's liability to third parties is limited to those obligations existing before its loss of partnership status; and

7. Once the secured party receives the consent of the remaining partner to exercise the management rights of SLT, the secured party becomes a partner, but its liability for pre-existing debts is not personal in nature.[22]

There are a number of flaws in the court's reasoning; this summary, however, focuses on the court's conclusion that SLT ceased to be a partner immediately upon default in paying its obligation to the secured creditor. That conclusion is the basis of many of the court's conclusions and therefore should be scrutinized.

The court does not indicate that the partnership agreement provides for automatic loss of partnership status on SLT's default under the security agreement. Unless there is such a provision in the partnership agreement or in the Texas Uniform Partnership Act, the court's conclusion is wrong. The court unpersuasively contends that a provision in the partnership agreement providing for dissolution of the partnership "when any partner makes an assignment for the benefit of creditors," is applicable to this case.[23] The court, tacitly recognizing that the security agreement does not constitute an assignment for the benefit of creditors, argues weakly that "the mere making of an assignment is not enough to create a dissolution. The intended effect of this subsection only occurs in a case like this when the secured party acts or seeks to protect its security interest through the foreclosure process."[24] The court's argument would have supported the position that a simple pledge, without more, does not abridge a prohibition on assignment; here, however, the analysis is weakened considerably by a provision in the partnership agreement that expressly permits each partner to grant a security interest in its share of the profits and surplus of the partnership.[25]

Further, the Texas Uniform Partnership Act does not support the court's conclusion. Rather, the section of the Act that addresses the absolute assignment of a partner's interest supports the opposite result. The Texas Uniform Partnership Act provides that "[a] conveyance by a partner of his interest in the partnership does not of itself dissolve the partnership, nor as

22. *Id.* at 612.
23. *Id.* at 607, n. 69.
24. *Id.*
25. *Id.* at 606

against the other partners in the absence of agreement, entitle the assignee, during the continuance of the partnership, to interfere in the management or administration of the partnership business or affairs . . .; but it merely entitles the assignee to receive in accordance with his contract the profits to which the assigning partner would otherwise be entitled."[26] Thus, although the security agreement permitted the secured party to receive the profits and surplus immediately upon SLT's default, the court should have concluded that the debtor remained a partner. The secured party is essentially an assignee, and thus presently entitled to receive profits and surplus.

The court also erroneously relied on sections of the Texas Business and Commerce Code (Code)[27] for the proposition that although SLT lost its partner status on default, it had the right to redeem its interest and again return to partner status before the sale of the collateral.[28] The Code provides guidelines for a secured party's disposition of collateral on default.[29] Section 9.504(d) of the Code states that "[w]hen collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein."[30] If, however, SLT lost its interest in profits and surplus immediately on default,[31] as the court concluded, then SLT had no rights to be disposed of by the secured creditor in a section 9.504 foreclosure sale. Such an illogical result cannot support the court's reasoning.

The court's conclusions may have been influenced by the special facts of this case, notably that the "remaining" partner and the secured creditor were related entities and that there was apparently no objection to the creditor's becoming a partner.[32] Another factor may have been SLT's challenge to a transaction entered into by the partnership after SLT's default.[33] If the court had found SLT still to be a partner, it would then have had to address liability issues associated with that transaction. The confusion in the court's opinion may stem, at least in part, from the confusing and often contradictory stands taken by the parties, particularly the defendant. For example, on April 12, 1986, almost five months after the secured party notified SLT of its default, the management committee made a cash call on behalf of the partnership on SLT and the other party. The defendant's counsel, during a hearing in the earlier New York case involving the same parties, stated to SLT

26. TEX. REV. CIV. STAT. ANN. art. 6132b, § 27 (Vernon 1970).

27. TEX. BUS. & COMM. CODE ANN. §§ 9.504(d) and 9.506 (Vernon Supp. 1990).

28. 718 F. Supp. at 607.

29. TEX. BUS. & COMM. CODE ANN. § 9.504(a) (Vernon Supp. 1990). "A secured party after default may sell, lease or otherwise dispose of any or all of the collateral . . . ." *Id.* Section 9.504(c) provides that "[d]isposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts." *Id.*

30. *Id.* at § 9.504(d).

31. Recall that the court's holding went even further—the court found that SLT's managements rights also automatically passed to the creditor, and SLT's partner status automatically ended. *See supra* note 22 and accompanying text.

32. One wonders, too, whether the court's references to SLT's attempts to muddy the waters and SLT's efforts to recuse the court played a part in the result, as well. See footnote 4, *supra*.

33. 718 F. Supp. at 610.

that "I think it is accurate that you are still a partner in the bank."[34] The defendant later changed its position, however, and eventually argued that SLT ceased to be a partner on the date of the notice of default, which notice the defendant described as the "foreclosure."[35]

The proper analysis, however, is that on default, SLT remained a partner, but the secured creditor, pursuant to the security agreement and as an "assignee," was entitled to receive any profits and surplus owed to SLT. Also, if the security agreement granted a security interest in the debtor's management rights, and if the secured creditor was entitled to exercise those rights on the default of SLT (subject to the consent of the other partner), then the secured party also had the right to exercise SLT's management rights if the other partner so consented. The court rejected SLT's argument that SLT's consent to management by the secured creditor was necessary by relying on its conclusion that the debtor was no longer a partner and therefore had no right to consent.[36] The court, however, could have rejected SLT's argument by finding that the management rights, which the secured creditor was entitled to exercise on SLT's default, included the right to consent to additional partners.

One lesson to be learned from *Thomas* is that if the partnership agreement permits partners to grant a security interest in their interest in the partnership, then the partnership agreement should also specify what happens when the partner defaults on the obligation secured by the partner's partnership interest. For example, the partnership agreement should specify whether such a default, by itself without further creditor action, causes a dissolution of the partnership or whether other consequences flow from the default. Further, the partnership agreement should require that all security agreements be made expressly subject to the partnership agreement (they should be anyway, but the courts and juries often benefit from the guidance), since it may often be the case that the non-defaulting partners do not have such a close relationship with the secured creditor. Finally and most importantly, the security agreement should expressly state under what conditions the partner's management rights may be exercised by the secured creditor.

2. PARTNERSHIP DISSOLUTION

a. *Khalaf v. Williams.*[37] The partnership law issue in *Khalaf* concerned the distinction between dissolution and termination of a partnership.[38] The plaintiff urged in his motion for new trial that the jury should have found, as

34. Plaintiff's Brief in Opposition to Motion of Certain Defendants to Dismiss Counts I-V and Count VII, Exhibits A and B.

35. Price Defendants' Memorandum in Support of Motion for Summary Judgment, page 8.

36. 718 F. Supp. at 607, n.67.

37. 763 S.W.2d 868 (Tex. App.—Houston [1st Dist.] 1988, *rev'd on other grounds*, 33 Tex. Sup. Ct. J. 354 (Mar. 28, 1990).

38. TEX. REV. CIV. STAT. ANN. art. 6132b, § 30 (Vernon 1970) provides that "[o]n dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed."

a matter of law, that the partnership was terminated. The court rejected the plaintiff's contention, noting that the evidence of intent to dissolve did not establish that the partnership was terminated as a matter of law.[39]

In *Khalaf* the plaintiff and defendant entered into a written partnership agreement by which the plaintiff would finance and the defendant would build a country and western club that the partnership would operate. The defendant later discovered that the plaintiff incorporated the business without including the defendant. Subsequently, the defendant either left the job site or was fired. The plaintiff sued for damages arising from breach of contract and other claims and the defendant asserted counterclaims for breach of contract and fraud. The jury entered a take nothing judgment for the plaintiff and awarded the defendant $181,229.85.[40]

On appeal, the plaintiff argued that, as a matter of law, the jury should have found that the partnership was terminated. The partnership agreement called for the partnership to continue until a specified date, unless terminated earlier by a partner's giving sixty days written notice or by the partnership forming a corporation. The court noted that the partnership did not create the corporation and that the notice given by the plaintiff failed to meet the sixty days notice requirement.[41] The court observed that, pursuant to the Texas Uniform Partnership Act,[42] a partner always has the power to dissolve the partnership.[43] Dissolution, however, is distinct from termination, which occurs only after the winding up of partnership affairs.[44] The court overruled the point of error, noting that while the evidence indicated an intent to dissolve, it apparently did not convince the jury that a termination occurred.[45]

b. *Nazarian v. Thomas.*[46] In this suit for the value of an interest in a "joint venture partnership"[47] brought by a partner who had given notice of dissolution, the court found that the dissolving partner's attempts to later rescind his notice of dissolution were ineffective and that the partnership was dissolved.[48] The court rejected the continuing partner's assertion that he had consented to the reinstatement.[49] The court found that the continuing part-

39. 763 S.W.2d at 871.
40. *Id.* at 869.
41. *Id.* at 871.
42. TEX. REV. CIV. STAT. ANN. art. 6132b, § 31 (Vernon 1970).
43. 763 S.W.2d at 871.
44. *Id.*; *see* TEX. REV. CIV. STAT. ANN. art. 6132b, § 30 (Vernon 1970).
45. 763 S.W.2d at 871. The court also determined that the plaintiff waived any error in the form of the jury issues submitted regarding the termination. *Id.* The plaintiff argued that the jury could not properly decide damages to be awarded the defendant without determining the termination date of the partnership. The special issue, however, instructed the jury to determine the termination date only if the jury decided that the partnership was terminated. Since the plaintiff had not objected to that issue, he did not preserve error. *Id.*
46. 767 S.W.2d 273 (Tex. App.—Fort Worth 1989, writ denied).
47. *Id.*
48. *Id.* at 275.
49. *Id.* The court rejected the partner's contention that he consented to the reinstatement in his pleadings that recited that the partnership was duly existing under the laws of the State of Texas, noting that those pleadings were consistent with the prior pleadings of the partner,

ner was obligated to pay the dissolving partner the value of his interest as of the date of dissolution or to secure the payment of that amount by a bond.[50] The court cited provisions in the Texas Uniform Partnership Act[51] that give the partner who did not wrongfully dissolve the partnership the right to continue the partnership for the agreed term.[52] Those provisions also obligate the continuing partner to pay the wrongfully dissolving partner the amount of the value of the dissolving partner's interest, less the damages caused by the dissolution.[53] The continuing partner in this case claimed no damages caused by the dissolution; the court, therefore, found that he owed the dissolving partner the full value of that partner's interest.[54]

c. *Pate v. McClain.*[55] *Pate* involved an improperly worded special issue submitted to the jury in a suit by a former partner in a law firm to recover his net interest in two contingent fee contracts on dissolution of the partnership. The jury found that the contingent fees were income of the partnership and awarded the plaintiff his share of the *gross* profits.[56] The court of appeals found that there was sufficient evidence establishing that the contingent fees were income of the partnership.[57] The court found, however, that the special issue requesting the jury to determine the amount that would reasonably compensate the plaintiff for his unpaid share of the profits of the partnership was improperly worded.[58] Recovery should have been limited to the amount of money necessary to compensate the plaintiff for his unpaid share of the *net* profits of the partnership.[59]

3. DEFECTIVE FORMATION OF LIMITED PARTNERSHIP

Hoagland v. Finholt.[60] In *Hoagland* the trial court granted the plaintiff declaratory relief, finding that a limited partnership had, in law, not been cre-

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which had alleged that the partnership was dissolved *and* duly existing under the laws of the State of Texas. *Id.* This decision illustrates the point that a dissolved partnership remains in existence until its affairs are wound up and its legal existence is terminated. *See supra* note 45.

50. 767 S.W.2d at 275.

51. TEX. REV. CIV. STAT. ANN. art. 6132b, § 31(2), 38(2)(b) (Vernon 1970).

52. *Id.* 767 S.W.2d at 274-75.

53. *Id.*

54. *Id.*

55. 769 S.W.2d 356 (Tex. App.—Beaumont 1989, writ denied).

56. *Id.* at 358.

57. *Id.* at 360. Two prior partnerships preceded the partnership in dissolution. The court, in its statement of the facts, noted that both of the contingent fee contracts had been entered into during the terms of the prior partnerships. *Id.* at 359-60. Nevertheless, on the formation of the new partnership, the office space remained the same, the files were unchanged, the plaintiff actively participated in both cases and the partnership paid the expenses in at least one of the two contingent fee cases. Although the facts are not clear, it appears that there was no formal accounting on the winding down of the prior partnerships. There was testimony that if the plaintiff had stayed with the firm, he would have shared in the other contingent fee. *Id.* at 360.

58. *Id.* at 363. The court also noted that there was no written partnership agreement and that all discussions of how profits and losses would be shared was oral. *Id.* at 364. The court opined that "[a] carefully drafted partnership agreement in writing may well have avoided this lawsuit." *Id.*

59. *Id.* at 363.

60. 773 S.W.2d 740 (Tex. App.—Dallas 1989, no writ).

ated and that the assets of the purported limited partnership reverted to the plaintiff—general partner.[61] Without reaching the issue of whether or not a limited partnership had been formed, the appellate court reversed the judgment of the trial court and remanded the case for further proceedings.[62] The court found sufficient evidence of mutual consideration between the parties, both in the form of their partnership agreement and in the benefits conferred or detriments suffered.[63] The *Hoagland* court held that regardless of the outcome of the partnership formation issue, the parties agreed to be co-owners of certain property in the ratio of seventy-five percent to twenty-five percent.[64]

The plaintiff—general partner's declaratory relief was based on the argument that because the limited partner made no contribution, a valid limited partnership could not have been formed under the Texas Uniform Limited Partnership Act,[65] and, therefore, all of the partnership's property became the property of the general partner.[66] The court, while specifically reserving the question of whether or not a partnership was formed, rejected the reversion argument, holding instead that the situation was similar to a corporation without a valid charter; the corporation's assets are liquidated, creditors are paid and the excess is distributed to the former shareholders or subscribers, as appropriate.[67] The court found no better reason to forfeit the limited partner's share of assets than there would have been to forfeit the plaintiff—general partner's share.[68]

4. Liability of Individual Partners

a. *Richard Gill Co. v. Jackson's Landing Owners' Ass'n.*[69] This case concerned the liability of a limited partner for assessments owed by the limited partnership to a condominium owners' association. The association sued the limited partnership and one of its limited partners, who was also the agent for the limited partnership in managing the condominium, for failing to pay assessments and for negligent failure to keep the books of the condominium project in good order. The defendants appealed the trial court's judgment against them.[70] The limited partner raised a point of error based on its status as a limited partner. The court noted that the safe harbor provisions in the Texas Uniform Limited Partnership act specifically permit a limited

61. *Id.* at 741.
62. *Id.* at 744.
63. *Id.* at 743-44.
64. *Id.* at 742-43.
65. Tex. Rev. Civ. Stat. Ann. art. 6132a (Vernon 1970).
66. 773 S.W.2d at 741. The court found a "reverse twist of irony" in the general partner's having filed a certificate of limited partnership reciting a "$0" contribution by the limited partner in exchange for a 25% partnership interest. *Id.*
67. *Id.* at 744.
68. *Id.* at 743.
69. 758 S.W.2d 921 (Tex. App.—Corpus Christi 1988, writ denied).
70. *Id.* at 922. The defendants' first point of error was that the limited partnership had no obligation, as developer, to pay the assessments. The court reviewed the condominium declaration and determined that the limited partnership constituted an "owner" under the declaration for the purpose of assessments. *Id.* at 924.

partner to exercise certain powers without becoming liable as a general partner.[71]

The association contended that the liability of the limited partner was based on the limited partner's own tortious conduct and its indemnification obligations under the management agreement with the limited partnership, rather than on its status as a limited partner. The court disagreed, however, reasoning that the cause of action and the association's right to the assessments were based on the covenants in the condominium declaration and not on the limited partner's failure to properly collect the debt.[72] The court also dismissed the association's contention that the limited partner was liable to the association based on its agreement to indemnify the limited partnership.[73] The court stated that a party other than the indemnitee can sue on an indemnification contract only if the contract is clearly made for the benefit of a third party.[74]

b. *Stephens v. Angelina National Bank.*[75] *Stephens* stands for the proposition that a general partner who signs a partnership agreement and a partnership certificate authorizing borrowing by the partnership from a bank will be liable for debts incurred on behalf of the partnership pursuant to the agreement and certificate.[76] The case involved three notes that were signed by the defendant's son. The evidence established that both the son and father had signed a partnership agreement, a signature card for the partnership and a partnership certificate authorizing borrowing by the partnership. The evidence also indicated that the bank would not have made the loans to the son alone, but rather relied on the father's financial strength. Further, the father acknowledged voluntarily signing the partnership agreement and the borrowing certificate. Certain tax records showed that the father was a general partner in the partnership. The court affirmed the trial court's judgment for the bank against the father on two grounds: (1) as a general partner of the partnership under the partnership agreement and borrowing certificate and (2) as a partner by invoking the doctrine of partner by estoppel.[77]

5. EXCULPATORY PROVISIONS

Grider v. Boston Co., Inc.[78] *Grider* involved an action by limited partners against general partners to recover allegedly excessive professional and ad-

71. *Id.* at 926; *see* TEX. REV. CIV. STAT. ANN. art. 6132a, § 8(b) (Vernon Supp. 1990). The court focused on § 8(b)(3), which states that a limited partner does not become liable as a general partner merely by acting as a "contractor, agent, or employee of the partnership or of a general partner." 758 S.W.2d at 926.

72. *Id.*

73. *Id.*

74. *Id.*

75. 772 S.W.2d 545 (Tex. App.—Beaumont 1989, writ denied).

76. *Id.* at 550.

77. *Id.* The partner by estoppel doctrine is set forth in TEX. REV. CIV. STAT. ANN. art. 6132b, § 16 (Vernon 1970).

78. 773 S.W.2d 338 (Tex. App.—Dallas 1989, writ denied).

ministrative fees.[79] The court of appeals upheld the trial court's judgment notwithstanding the verdict for the defendant general partners, disregarding the jury's verdict for $750,000 in actual damages and $250,000 in punitive damages.[80] The partnership agreement gave virtually unfettered authority to the general partner to expend partnership funds and to take all necessary actions to accomplish the partnership's purposes, subject only to liability for willful malfeasance or fraud. The partnership agreement further provided that the general partner was to act as managing partner and provide to the partnership certain administrative and management staff and services at cost. The partnership agreement did not otherwise limit the general partner's right to incur and receive reimbursement for administrative expenses.

The *Grider* court found no evidence of fraud or willful malfeasance in the record and concluded that the partnership agreements fully protected the general partner against liability for simple mismanagement, the greatest complaint the court could find from the record.[81] In response to the plaintiff's breach of fiduciary duty allegations, the court observed that a fiduciary can contract with his beneficiaries and can limit his liability, so long as equal bargaining power exists.[82] A fiduciary's ability to contract is also subject to the public policy limitations precluding limitation of liability for (1) self-dealing, (2) bad faith, (3) intentional adverse acts, and (4) reckless indifference with respect to the beneficiary's best interest.[83] The court found no evidence of inappropriate self-dealing and noted that, while a fiduciary's self-dealing does expose the transaction to scrutiny for fairness, it does not create automatic liability.[84]

Based on the facts, including the partnership agreement, the *Grider* court suggested that the case was submitted to the jury on the wrong theory.[85] It is difficult to determine from the opinion whether the plaintiff attempted to make something of nothing, made the best of bad facts, or mustered and presented the wrong facts. For example, one cannot tell from reading the case whether an attack on the defendant's "cost" would have been successful. Recall that the general partner was limited to recouping the cost of its administrative and overhead services provided to the partnership.[86] The court easily concluded that, in the face of the protective language contained in the partnership agreement, a simple showing that the charges were above those customarily charged by other similarly situated partnerships was insufficient.[87]

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79. *Id.*
80. *Id.* at 339.
81. *Id.* at 341-42.
82. *Id.* at 343.
83. *Id.*
84. *Id.*
85. *Id.* at 340.
86. *Id.* at 341.
87. *Id.* at 340. Excessive charges were a key jury finding which lead to the trial court's judgment notwithstanding the verdict.

6. NATURE OF PARTNER'S INTEREST

a. *Harris v. Harris*.[88] In *Harris*, a divorce action, the court addressed the characterization of a partner's interest in a partnership as community property or separate property.[89] At issue was the characterization of the husband's partnership interest in his former law firm, and his interest in a certain 30% contingent fee arrangement of the firm.[90] In the trial below, the court ruled that both interests were the husband's separate property.[91] The court of appeals, in affirming the judgment of the trial court,[92] discussed the entity theory of partnership adopted in Texas, stating that "partnership property is owned by the partnership entity, not by the individual partners."[93] Consequently, the court reasoned that partnership property is neither separate nor community property.[94] The partner's interest in the partnership, his right to receive his share of partnership profits and surplus, is subject to characterization as either separate or community property.[95]

The husband and wife in *Harris* had been married and divorced from each other once before. In the prior divorce, the husband's partnership interest was adjudged to be his separate property.[96] During the second marriage, the husband executed a second partnership agreement that controlled and altered the terms of the husband's withdrawal from the firm. The court ruled, however, that the husband's interest remained separate property, stating that the second partnership agreement did not alter the characterization of the husband's interest, since there was no evidence indicating the acquisition of any additional interest during the second marriage.[97] The court analogized the stock splits and increases in enunciating the rule that "mutations and increases in separate property remain separate property."[98] Similarly, the court found that the agreement concerning the division of the contingent fee executed during the second marriage did not create any rights, but rather clarified and defined each partner's share.[99]

While the court found that increases in the value of separate property resulting from fortuitous circumstances such as stock splits will not be recharacterized as community property, a right of reimbursement to the

88. 765 S.W.2d 798 (Tex. App.—Houston [14th Dist.] 1988, writ denied).

89. *Id.* at 800-01.

90. *Id.* At trial, it was alleged that the value of the payments to the husband under a buy-out agreement among the partners of the law firm was worth approximately $500,000 and that the value of the husband's interest in the contingent fee was worth several million dollars.

91. *Id.*

92. *Id.* at 806.

93. *Id.* at 802 (*citing Marshall v. Marshall*, 735 S.W.2d 587, 593-94 [Tex. App.—Dallas 1987, writ ref'd n.r.e.]); *see* Bromberg, *Source and Comments*, TEX. REV. CIV. STAT. ANN. art. 6132b, §§ 1, 5 (Vernon 1970).

94. 765 S.W.2d at 802. *Id.*

95. *Id.*

96. *Id.* at 802-3.

97. *Id.* at 803.

98. *Id.*

99. *Id.* at 804. There was also testimony that at least two partners who departed from the firm before the execution of the contingent fee division agreement received their proportionate interest in the contingent fee. *Id.*

community may be due for the time, toil and talent of the spouse in enhancing the separate property.[100] The court observed, however, that no evidence demonstrated that the husband's share in the contingent fee was based on his efforts in the case and, therefore, no right of reimbursement accrued.[101]

b. *Marshall v. Quinn-L Equities, Inc.*[102] This summary judgment case addresses the nature of a limited partnership interest in a limited partnership whose principal objective is to acquire and develop real estate. *Marshall* also raises pertinent liability issues for attorneys who represent or have represented a general partner in the process of creating a limited partnership. The case is a consolidation of 26 separate actions involving 26 limited partnerships. A law firm that rendered legal services in connection with the limited partnership offerings was the defendant in 22 of the cases. The plaintiffs brought numerous complaints against the defendant law firm including alleged violations of federal and state securities laws,[103] fraud in a transaction involving real estate or stock in a corporation or joint stock company,[104] violations of the Texas Deceptive Trade Practices Act (DTPA),[105] negligence, professional liability and negligent misrepresentation,[106] breach of fiduciary duty and constructive fraud,[107] and breach of contract.[108] The claims that raise partnership law issues and, to a limited extent, the claims that raise attorney liability issues, are discussed in this summary.

In considering the plaintiffs' allegations of fraud in a transaction involving real estate or stock in a corporation or joint stock company, the court observed that the plaintiffs' argument was based on the contention that the limited partnership interests "constitute real estate because the principal objective of the limited partnerships was real estate acquisition or development."[109] The court rejected this claim, finding that the plaintiffs purchased limited partnership interests and not real estate.[110] The court stated that "[t]he fact that the main objective in formulating the limited partnership was to acquire and develop real estate does not transform the interests purchased by the plaintiffs into real property."[111] Rather, the court held that the lim-

100. *Id.* at 805.
101. *Id.* at 806.
102. 704 F. Supp. 1384 (N.D. Tex. 1988).
103. *Id.* at 1387-1391. The plaintiffs alleged violations of section 12 of the Securities Act of 1933, 15 U.S.C. § 771 (1988); section 15 of the Securities Act of 1933, 15 U.S.C. § 77o (1988); section 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78t[a] (1988); and sections 33A(1) and (2) and 33F of the Texas Securities Act (TEX. REV. CIV. STAT. ANN. art. 581-1, § 33A and F (Vernon 1989)).
104. 704 F. Supp. at 1392. The plaintiffs alleged violations of TEX. BUS. & COMM. CODE ANN. § 27.01 (Vernon 1987).
105. 704 F. Supp. at 1392; *see* TEX. BUS. & COMM. CODE ANN. §§ 17.41-63 (Vernon 1987).
106. 704 F. Supp. at 1394.
107. *Id.* at 1395.
108. *Id.* at 1396.
109. *Id.* at 1392.
110. *Id.* The court's finding is consistent with section 26 of the Texas Uniform Partnership Act, which defines a partner's interest in the partnership as his share of the profits and surplus of the partnership. TEX. REV. CIV. STAT. ANN. art. 6132b, § 26 (Vernon 1970).
111. 704 F. Supp. at 1392.

ited partnership interests "are the kinds of instruments traditionally understood to be securities and intangibles."[112] Consequently, the court rejected the plaintiffs' contention that they purchased "goods" and were therefore consumers under the DTPA.[113] The court distinguished the cases relied on by the plaintiffs that suggested some securities are also interests in real property and therefore "goods" under the DTPA by reiterating that "the purchase of limited partnership interests is not the purchase of a real estate interest . . . and thus . . . such a security is not a 'good' under the DTPA."[114]

The *Marshall* court did find, however, that the limited partners may have purchased services covered by the DTPA, reasoning that services related to the sale of securities may be qualifying services when the services are also the objective of the transaction.[115] Even though the important objective of the transaction was the exchange of money for securities, the court noted that the services the general partner would perform on behalf of the limited partnerships were key objectives of the transaction.[116] Consequently, the plaintiffs met their evidentiary burden to avoid summary judgment, even though the law firm and the plaintiffs were not in privity and the law firm had not provided the legal services specifically to the plaintiffs.[117]

The plaintiffs' claims of negligence, professional liability and negligent misrepresentation against the law firm were also of interest. The plaintiffs contended that the law firm represented the limited partnerships and by implication represented the investors as well.[118] The court rejected that argument and granted summary judgment for the law firm, observing that even if the law firm were counsel for the limited partnership, that would not automatically make it counsel for the investors.[119]

c. *Sunbelt Service Corp. v. Vandenburg.*[120] Although this case is of primary importance to creditors for the point made in response to a usury claim based on *Alamo Lumber v. Gold*,[121] *Sunbelt* is briefly reviewed here because it involved the liability of general partners of a limited partnership. The court found that when general partners of a limited partnership agree to personal liability for a portion of the theretofore non-recourse indebtedness of the partnership[122] as a condition to a lender's forbearance after default,

112. *Id.* at 1393.
113. *Id.*
114. *Id.*
115. *Id.*
116. *Id.* at 1394.
117. *Id.* at 1393.
118. *Id.* at 1394.
119. *Id.* at 1395. The plaintiffs' claims highlight the potential value to the attorney of sending a representation letter to the client detailing the identity of the client for whom the attorney is providing services. The plaintiffs also brought claims for breach of fiduciary duty, which the court rejected because the plaintiffs failed to establish the existence of a fiduciary relationship. The court also observed that the private placement memorandum cautioned investors not to construe the contents of the memorandum as legal advice and urged potential investors to seek independent legal counsel. *Id.* at 1396.
120. 774 S.W.2d 815 (Tex. App.—El Paso 1989, writ denied).
121. 661 S.W.2d 926 (Tex. 1984).
122. A "non-recourse" indebtedness is one for which the maker has no personal liability;

the general partner is not considered to have assumed the debt of a third party.[123] Under *Alamo Lumber* if a lender requires a borrower to assume the debt of a third party owed to the lender as a condition to the lender's extension of credit, then the amount of the assumed obligation may be considered interest charged on the loan.[124] Although the court's discussion was somewhat difficult to follow, the result is entirely sensible.

7. PROCEDURAL ISSUES

a. Authority of Individual Partner to Sue on Behalf of Partnership; Proper Citation

(1) *Chien v. Chen.*[125] *Chien* addressed the issue of whether the entity theory of partnership contained in the Texas Uniform Partnership Act[126] denies an individual partner the legal authority to prosecute a cause of action held by the partnership.[127] The appellate court held that the statute did not have that effect, and reversed.[128] *Chien* involved a suit for breach of contract, common law fraud, fraud in a real estate transaction[129] and violations of the DTPA[130] brought by an individual within the statute of limitations period. The plaintiff, who had invested in property brought to his attention by the defendants, later sold the property to a trustee whose undisclosed principal was one of the defendants. That defendant subsequently sold the property for a $700,000 profit. The plaintiff, an individual, made numerous amendments to his petition, including several amendments filed after the statute of limitations period had run, naming several individuals and a partnership as co-plaintiffs. The trial court entered partial summary judgment against the plaintiffs.[131]

In examining the issue of whether the entity theory of partnership denied the original plaintiff legal authority to prosecute a cause of action owned by the partnership, the court of appeals first reviewed the common law rules in effect before the enactment of the Texas Uniform Partnership Act. The court noted that at common law, a partnership is not a person for purposes of litigation and therefore cannot maintain suit in its own name.[132] Therefore, all partners were required to join as parties to enforce a partnership claim unless an exception applied.[133] The court noted two exceptions that existed at common law for actions based on contract: (1) where the partner

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the debt may be satisfied only from collateral serving as security for the debt. Here, mechanically this was accomplished by the general partner's borrowing from the lender on a full liability basis an amount sufficient to bring the partnership debt current.

123. 774 S.W.2d at 817.
124. *Id.*
125. 759 S.W.2d 484 (Tex. App.—Austin 1988, no writ).
126. TEX. REV. CIV. STAT. ANN. art. 6132b, § 5 (Vernon 1970).
127. 759 S.W.2d at 489.
128. *Id.* at 492.
129. *See* TEX. BUS. & COMM. CODE ANN. § 27.01 (Vernon 1987).
130. *Id.* at §§ 17.41-63.
131. 759 S.W.2d at 488.
132. *Id.* at 489.
133. *Id.*

making the contract is the only known partner, the partnership constitutes an undisclosed principal and an action may be brought in the name of all partners or just that one partner; and (2) where there is a dormant or silent partner, that partner will constitute an undisclosed principal and may join in the action but is not required to do so.[134]

The court then reviewed a 1939 amendment to the Texas Rules of Civil Procedure[135] that permitted a partnership to maintain suit in the partnership name, provided that the true parties may be substituted for the partnership on motion by the court or a party.[136] The court characterized the rule as permissive and concluded that the rule "presumes a *continuation* of the common-law rules."[137] The court then turned to an analysis of the Texas Uniform Partnership Act, citing the Act's adoption of the entity theory of partnerships and its continuation of the common law in any case not provided for in the Act.[138] The court concluded that there was no legislative intent requiring all suits to be brought in the partnership name.[139]

The statute of limitations issue raised in the case indirectly involved partnership law. Although the original plaintiff filed his petition within the two-year limitations period, he first alleged the existence of a partnership after the expiration of the two-year period. The court determined that the amended petition related back to the filing of the original petition because the cause of action remained the same.[140] Therefore, the bar of limitations was not established as a matter of law.[141]

(2) *ISO Production Management 1982, Ltd. v. M & L Oil and Gas Exploration, Inc.*[142] This case addressed the validity of a default judgment in a suit against a partnership when citation was directed to an individual rather than the partnership.[143] The plaintiff sued the partnership in its assumed name, but the citation was directed to the president of the general partner of the limited partnership. The court observed that the limited partnership was properly sued in its partnership name since, under Texas law, a partnership may be sued in its assumed name without the partners being joined as defendants.[144] The Court of Appeals voided the default judgment, however, because the citation was not directed to the limited partnership, which was

134. *Id.* at 490.

135. Tex. R. Civ. P. 28.

136. 759 S.W.2d at 491.

137. *Id.* (emphasis in original).

138. *Id.* at 491. *See* TEX. REV. CIV. STAT. ANN. art 6132b, § 5 and comments (Vernon 1970).

139. 759 S.W.2d at 492. The court further rejected the defendants' contention "for the final reason that it necessarily presumes that the Legislature acted quite irrationally." *Id.*

140. *Id.* at 493.

141. *Id.*

142. 768 S.W.2d 354 (Tex. App.—Waco 1989, no writ).

143. *Id.* at 355-56.

144. *Id. See* Tex. R. Civ. P. 28; *see also* Chien v. Chen, 759 S.W.2d 484 (Tex. App.—Austin 1988, no writ) (discussing the legal authority of an individual partner to prosecute a cause of action held by the partnership).

the sole defendant, but rather to an individual.[145]

b. Accounting Prerequisite to Lawsuit Between Partners

Kartalis v. Commander Warehouse Joint Venture.[146] Well-settled partnership law establishes that one partner may not sue another partner unless there has first been an accounting to settle all financial matters between them.[147] Among other benefits, the rule tends to promote judicial economy by eliminating claims that may be offset or otherwise adjusted by amounts owed by the claimant partner to the other partner. The *Kartalis* case recognized an exception to the general rule that if the matter is so simple and free of complexities that it can be readily disposed of, then the normal prerequisite accounting is not required.[148] In this case the defendant partner had refused to pay a straightforward "cash call" made of all partners.[149] The joint venture agreement specifically provided for the obligation of each partner to pay his proportionate share of operating expenses and the procedure for determining and making the cash call.

The court explained, as a predicate to its analysis, that this case involved a joint venture and that joint ventures are generally governed by the same rules of law that apply to partnerships, including the "free from complexity" rule that controlled the result here.[150] What the court did not say, having no reason to in this case, is that Texas courts have identified one crucial difference between joint ventures and partnerships. To find that a joint venture relationship exists, and thereby gives rise to the application of partnership rules, the court must first find that the parties have agreed to share *losses* as well as profits.[151] Therefore, if a business relationship exists between two or more persons for a limited purpose, such as to develop and own a single real estate project (the limited purpose being the feature that normally distinguishes a joint venture from a membership), but the parties do not share losses, then the relationship may not be governed by Texas partnership law.

8. Scope of Fiduciary Duty

a. *Eglin v. Schober.*[152] In this interpleader action brought by the holder of an oil and gas lease, the trial court imposed a constructive trust over the

145. 768 S.W.2d at 356. The citation failed to comply with Rule 101 of the Texas Rules of Civil Procedure, which was subsequently repealed on January 1, 1988 and replaced by Rule 99. *See* Tex. R. Civ. P. 99. The court applied rule 101 in this case because it was the law in effect on the date of the issuance of the citation. 768 S.W.2d at 355.

146. 773 S.W.2d 393 (Tex. App.—Dallas 1989, no writ).

147. *Id.* at 394; *see* Chipley v. Smith, 292 S.W. 209, 209 (Tex. Comm'n App. 1927, opinion adopted).

148. 773 S.W.2d at 395.

149. *Id.* at 394. A cash call refers to a request for a cash contribution to pay partnership expenses.

150. *Id.* at 394-95.

151. See, e.g., Tex-Co Grain Co. v. Happy Wheat Growers, Inc., 542 S.W.2d 934, 937-38 (Tex. Civ. App.—Amarillo 1976, no writ).

152. 759 S.W.2d 950 (Tex. App.—Beaumont 1988, writ denied).

mineral interests in favor of the appellees claiming title from one of three joint venturers. The issue raised was whether a constructive trust could arise from a breach of the fiduciary duty existing because of the relationship of the venturers or whether establishing a fiduciary duty separate and apart from that arising from the joint venture relationship is necessary.[153] The court held that no prior and separate fiduciary duty was required.[154]

The jury in the trial below found that there was a written joint venture agreement.[155] The appellees claimed that they were the successors-in-interest to the joint venturer named in the agreement and argued that a constructive trust arose out of that agreement. The appellants, in addition to denying the existence of a joint venture and the validity of the joint venture agreement, argued that no constructive trust could exist because no fiduciary relationship existed before and separate and apart from the joint venture agreement.

The court noted that a fiduciary relationship exists as a matter of law in certain situations, including the relationship between general partners, and observed that a joint venture is similar to a partnership and should be governed by the same basic rules.[156] The court stated that a constructive trust can be based on the prevention of unjust enrichment or on a violation of a fiduciary duty.[157] The court rejected the appellants' argument that to establish a constructive trust there must exist a prior and separate fiduciary relationship,[158] concluding that "the really important circumstance from which the law will raise a constructive trust is the breach of a confidential relationship and . . . a partnership or joint venture is such a confidential relationship."[159]

b. *Johnson v. J. Hiram Moore, Ltd.*[160] In *Johnson* a general partner collected a 15% "developer's fee" from contractors on tenant finish-out contracts for a building that was built, owned and operated by the limited partnership. The limited partners, two of whom were building tenants, brought suit for breach of fiduciary duty. The limited partners contended

153. *Id.* at 951.

154. *Id.* at 958.

155. *Id.* at 953. The agreement was a one paragraph statement signed by two of the venturers certifying that the third venturer had an undivided one-fourth interest in certain real property. *Id.* at 951.

156. *Id.* at 953; *see also*, Chien v. Chien, 759 S.W.2d 484, 494 n.6 (fiduciary relationship arises as a matter of law between partners.)

157. 759 S.W.2d at 955.

158. *Id.* at 957. The appellants relied on the following language from Consolidated Gas & Equipment Co. v. Thompson, 405 S.W.2d 333, 336-337 (Tex. 1966): "for a constructive trust to arise, there must be a fiduciary relationship before, and apart from, the agreement made the basis of the suit." The court in *Eglin* distinguished the *Consolidated Gas* case observing that no joint venture was found to exist in the latter case. 759 S.W.2d at 957.

159. *Id.* at 958 (citing with approval the opinion of the court in Gaines v. Hamman, 163 Tex. 618, 358 S.W.2d 557 (1962)).

160. 763 S.W.2d 496 (Tex. App.—Austin, 1988, writ denied). *Johnson* was a highly publicized case concerning Ruben Johnson's activities as general partner of a limited partnership that built, owned and operated the building then known as United Bank Tower in Austin, Texas.

that a fiduciary relationship existed between them and the general partner and that the general partner, by failing to disclose the fees paid by the contractors, violated that fiduciary duty. Nineteen limited partners intervened in the suit, denying that the general partner had breached his duty and pleading that the limited partnership agreement authorized the collection of the fees. The jury, however, agreed with the plaintiffs and awarded actual and exemplary damages.[161]

On appeal, the general partner presented four main arguments: (1) no fiduciary duty existed because the relevant relationship was one of landlord and tenant;[162] (2) the partnership and not the individual partners owned any claim for a breach of the fiduciary duty and the partnership had ratified the general partner's actions;[163] (3) the fee was authorized by the partnership agreement;[164] and (4) the exemplary damages were excessive.[165]

The court termed the landlord/tenant relationship immaterial, noting that the "additional landlord/tenant relationship with one's partners does not diminish" the fiduciary duty owed to those partners.[166] The court also considered it significant that the general partner tied the roles of landlord and partner together by discussing concurrently with one tenant both the purchase of a limited partnership interest and the lease of office space, and by offering to finance the purchase of the partnership interest and the tenant finish-out work.[167]

The court also rejected the general partner's claim that the partnership owned the claim for breach of duty, observing that the plaintiffs, and not the partnership, paid the finish-out construction fees.[168] Although the plaintiffs also asserted claims on the partnership's behalf at trial, those claims were severed before judgment was rendered on the individual partners' claims.[169] The court found that the general partner's failure to disclose to the partners that he would collect a developer's fee from the construction fees paid by the limited partners was a breach of the duty he owed to those partners.[170] Because the partnership had no claim to share in the individual partners' recoveries, the partnership's ratification of the general partner's action was not controlling.[171]

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161. *Id.* at 498. One plaintiff received $14,494.00 as actual damages and $463,202.52 as exemplary damages; the second plaintiff received $74,801.00 in actual damages and $694,803.78 in exemplary damages. *Id.*

162. *Id.* at 499.

163. *Id.*

164. *Id.* at 500.

165. *Id.* at 502. The court observed that the exemplary damages awarded one plaintiff were nine times larger than the actual damages, while the exemplary damages of the second plaintiff were more than 33 times the actual damages awarded. *Id.*

166. *Id.* at 499.

167. *Id.*

168. *Id.*

169. *Id.* The general partner also challenged the lower court's action in severing the causes, but the court of appeals found that the district court did not abuse its discretion in ordering the severance. *Id.* at 502.

170. *Id.* at 499.

171. *Id.*

Finally, the court reviewed the partnership agreement and determined that despite fairly broad language permitting the general partner to receive fees,[172] the language allowing receipt of fees was restricted by another section of the partnership agreement.[173] The partnership agreement limited the permissible fees to management fees, leasing commissions, the general partner's fee and an interim loan guaranty fee.[174] Further, the court observed that the general partner admitted at trial that the developer's fee was not in any of those four categories.[175]

While the court felt that the general partner's actions offended the "public's sense of justice and propriety and merits punishment in an amount sufficient to deter similar disloyalty on the part of other fiduciaries,"[176] the court felt that the exemplary damages awarded to one of the plaintiffs was excessive and suggested a remittitur, which was accepted by that plaintiff.[177]

9. VALUATION OF PARTNERSHIP INTEREST

Keith v. Keith.[178] One of the issues raised by this divorce case was whether the determination of value formula in a partnership agreement was applicable in the event of the divorce of one of the partners. The court refused to apply the formula, reasoning that the partnership had not been terminated and noting that "the formula set forth in the partnership agreement with respect to death or withdrawal of the partner is not necessarily determinative of the value of a spouse's interest in the ongoing partnership as of the time of divorce."[179] Apparently, if the partners intend to specify a valuation

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172. *Id.* at 500. Section 9.1 of the partnership agreement stated in part:

> The General Partner shall be entitled to enter into any and all contracts with third parties, himself or with an affiliate of himself, including contracts pursuant to which the contracting party will perform any function which the General Partner is obligated to perform hereunder. . . . Each Limited Partner, by his execution of a counterpart of this agreement agrees that any and all fees, commissions and other considerations received by the General Partner or any and all affiliates pursuant to contracts permitted under this Article IX shall be the sole and exclusive property of the recipient, that the Partnership shall have no claim whatsoever therein, and that the participation by the General Partner or an affiliate in any such permitted contract shall not constitute a breach by the General Partner or the participant of any duty either of them may owe the Limited Partners of the Partnership. . .

Id.

173. *Id.*

174. *Id.* Section 7.1 of the partnership agreement stated: "Except as provides elsewhere in this Partnership Agreement for management fees and leasing commission fees as provided in Section 9.1, the General Partner's fee and the interim loan guaranty fee, no Partner shall receive compensation for services rendered in the initial development, construction and leasing of the Partnership property." *Id.*

175. *Id.*

176. *Id.* at 503. The court stated that, by taking the developer's fees, the general partner "acted entirely in his own interest and followed the morals of the market place instead of the strict loyalty demanded of a fiduciary." *Id.*

177. *Id.* Exemplary damages awarded to that plaintiff equaled thirty-three times the actual damages. The revised exemplary damages equaled nine times the actual damages awarded to that plaintiff. *Id.*

178. 763 S.W.2d 950 (Tex. App.—Fort Worth 1989, no writ).

179. *Id.* at 953.

formula applicable upon the divorce of one of the partners, the partnership agreement should include such a provision.[180]

Another issue in the *Keith* case, although not specifically related to partnership law, dealt with professional good will. The husband contended that the trial court erred by failing to determine the value of good will attributable to him personally as opposed to good will attributable to the partnership. The court observed that professional good will attaches to the person, is not property in the estate of the parties and, therefore, is not divisible on divorce.[181] The court of appeals concluded, however, that the husband's failure to request findings of fact and conclusions of law constituted a waiver of any error in the trial court's failure to make such a finding.[182]

180. The trial court apparently found that the wife would not have signed the partnership agreement if she had thought it would defeat her community interest in the partnership. *Id.* The court of appeals declined to rule on the point of error related to that issue, since it had declined to apply the valuation formula contained in the partnership agreement to which the wife had consented in writing. *Id.*

181. *Id.* at 952.

182. *Id.* at 953.