LLCs AND PARTNERSHIPS: TRENDS AND RECENT DEVELOPMENTS

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CHAPTER 4

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I. Entity Census

Formation statistics for the basic forms of Texas business entities (and initial registrations for Texas limited liability partnerships) in calendar years 2013 and 2014 are shown below.

Texas Entity Formations

	2014	2013
Limited liability companies	126,091	110,882
For-profit corporations	23,750	22,555
Limited partnerships	5,888	5,650
Professional corporations	814	844
Professional associations	707	833
Limited liability partnerships (initial registrations)	758	754

The pace of entity formations was brisk during the first half of 2015, and limited liability companies (LLCs) continue to be the overwhelming choice of entity. In a press release dated July 16, 2015, the Secretary of State announced that 83,235 certificates of formation had been filed for new for-profit corporations, professional corporations, professional associations, and LLCs from January 1, 2015, through June 30, 2015. This number represents an increase of almost 4% when compared to formations during the same period in 2014. LLCs comprised the overwhelming majority of new business filings (64,221 of the 83,235 formations).

The total population of Texas filing entities as of June 1, 2015, was as follows:

Active Texas Entities as of June 1, 2015

Limited liability companies	676,626
For-profit corporations	364,826
Limited partnerships	132,514
Professional corporations	17,700
Professional associations	19,482
Limited liability partnerships	3,651

II. Amendments to LLP Provisions of Business Organizations Code Effective January 1, 2016

Effective January 1, 2016, the Business Organizations Code (BOC) was amended to eliminate the annual renewal feature of the Texas limited liability partnership (LLP) provisions and replace it with an annual reporting requirement. By March 31 of each year, the Secretary of State is required to notify each LLP that had an effective registration as of December 31 of the preceding year that the annual report and applicable filing fee are due on June 1 of that year and that the LLP's registration will be terminated unless the report is filed accompanied by the required filing fee on or before May 31 of the following calendar year. Tex. Bus. Orgs. Code Ann. § 152.806(b) (eff. Jan. 1, 2016). The annual report must state the name of the partnership and the number of partners as of the date of filing the report (or in the case of a report that is past due, the number of partners as of May 31 of the year in which the report was due). Tex. Bus. Orgs. Code Ann. § 152.806(a) (eff. Jan. 1, 2016). The fee for filing the annual report is $200 per partner on the date of filing of the report (or in the case of a report that is past due, the number of partners as of May 31 of the year in which the report was due). Tex. Bus. Orgs. Code Ann. § 4.158(2) (as amended eff. Jan. 1, 2016).

The statute essentially provides a one-year grace period after the due date for an annual report. The registration of an LLP that does not file an annual report or pay the required filing fee on or before May 31 of the calendar year following the year in which the report or fee was due is automatically terminated. Tex. Bus.

Orgs. Code Ann. § 152.806(c) (eff. Jan. 1, 2016). During the three years following the termination of an LLP's registration, the LLP may reinstate its registration as described below.

If an LLP's registration is terminated based on the failure to file an annual report, the partnership may reinstate its registration by complying with the statutory reinstatement requirements within three years following the date of termination of the registration. Tex. Bus. Orgs. Code Ann. § 152.806(e)-(g) (eff. Jan. 1, 2016). To reinstate its registration, the partnership must file an application that contains: (1) the name of the partnership; (2) the effective date of the termination; and (3) a statement that the circumstances giving rise to the termination will be corrected by filing an annual report and paying the filing fee for each year that an annual report was not filed, including the annual report and filing fee due that year. Tex. Bus. Orgs. Code Ann. § 152.806(e) (eff. Jan. 1, 2016). The application for reinstatement must be accompanied by a tax clearance letter from the Comptroller stating that the LLP has satisfied all of its franchise tax liabilities under the Tax Code, and the annual reports and fees for each year since the last annual report was filed must be filed at the same time as the application for reinstatement. Tex. Bus. Orgs. Code Ann. § 152.806(f), (g) (eff. Jan. 1, 2016).

The 2015 amendments also include a provision regarding the effect of acceptance by the Secretary of State of an LLP registration and a provision specifying that "substantial compliance" is the standard with respect to the registration and annual reporting requirements. Effective January 1, 2016, an LLP registration that is accepted by the Secretary of State is an effective registration and is conclusive evidence of the satisfaction of all conditions precedent to an effective registration. Tex. Bus. Orgs. Code Ann. § 152.802(c-1) (eff. Jan. 1, 2016). Additionally, except in a proceeding by the state to terminate an LLP's registration, the registration continues in effect so long as there has been substantial compliance with the registration and annual reporting requirements of the statute. Tex. Bus. Orgs. Code Ann. § 152.802(k) (eff. Jan. 1, 2016). This standard should mitigate potential liability concerns arising from minor compliance errors, such as an error in reporting the number of partners.

III. Changes to Reporting Requirements for Limited Partnerships Effective January 1, 2016

Since 1993, the limited partnership statutes in Texas have contained a periodic reporting requirement. Under these provisions, currently codified at Tex. Bus. Orgs. Code Ann. §§ 153.301-153.310, the Secretary of State notifies each domestic limited partnership and each foreign limited partnership registered to transact business in Texas when its periodic report is due (not more often than once every four years), and a limited partnership that fails to comply with the reporting requirement is subject to forfeiture of its privileges and ultimately involuntary termination of its certificate of formation or certificate of registration. When these statutory provisions were enacted, limited partnerships were not subject to the Texas franchise tax, and the periodic reporting provisions served as a mechanism for the Secretary of State to clear its rolls of defunct limited partnerships. Not infrequently, limited partnerships that were not defunct also overlooked the reporting requirement and found themselves involuntarily terminated. There are reinstatement provisions, but various thorny and worrisome legal questions can arise in connection with the inadvertent involuntary termination of a limited partnership under these provisions.

When the franchise tax was expanded in 2008 to encompass limited partnerships, annual reporting requirements associated with the required franchise tax filings also became applicable to limited partnerships. Limited partnerships remained subject to the periodic reporting requirements under the BOC in addition to the report required in connection with its franchise tax filing obligations. The report that limited partnerships have been required to file under the Tax Code is an ownership information report. Professional associations, which also became subject to the franchise tax in 2008, likewise became required to file the ownership information report under the Texas Tax Code in addition to an annual report that is required for professional associations under the BOC. (Professional associations have long been subject to an annual report requirement under the Texas Professional Association Act and BOC.) The ownership information report calls for somewhat different information from the public information report that corporations and LLCs are required to file under the Tax Code, and the ownership information report is not available to the public. These different reporting requirements

resulted in some inconsistencies, gaps, and confusion regarding the information supplied by corporations, LLCs, limited partnerships, and professional associations.

Effective January 1, 2016, the Tax Code was amended to require a limited partnership that is a taxable entity to file the same annual public information report that corporations and LLCs are required to file. Tex. Tax Code Ann. § 171.203 (as amended eff. Jan. 1, 2016). Correspondingly, the BOC was amended to narrow the application of the periodic reporting requirement under the BOC. Under the amended provisions of the BOC, only limited partnerships that are not required to file a public information report with the Comptroller under the Tax Code (i.e., limited partnerships that qualify as "passive" entities and that thus are exempt from the franchise tax) are still subject to the periodic reporting requirement under the BOC. Tex. Bus. Orgs. Code Ann. § 153.301 (eff. Jan. 1, 2016). The annual reporting requirement contained in the BOC for professional associations is repealed effective January 1, 2016, and the Tax Code is amended to require professional associations to file a public information report.

IV. If it Quacks Like a Duck...: Inadvertent Partnerships

In 2014, a judgment in excess of $535 million was rendered in Dallas County in *Energy Transfer Partners, L.P. v. Enterprise Products Partners, L.P.* based on a jury verdict that the plaintiff and defendant formed a partnership and that the defendant breached its duty of loyalty to the plaintiff. This case was heavily covered in the legal press and has been referred to as a "partnership-by-ambush" case. In connection with their discussions regarding a proposed joint venture to construct and operate an oil pipeline, the parties executed a series of letter agreements and other writings that stated that the parties were not legally obligated to each other and did not create a partnership. However, the parties conducted activities relating to marketing and preliminary work on the project and publicly referred to their relationship on numerous occasions as a joint venture. After the deal fell apart and the defendant and another party joined forces to pursue their own pipeline project, the plaintiff sued to establish that it had formed a partnership with the defendant and that the defendant had breached its duty of loyalty to the plaintiff. The defendant argued that there was no partnership based on its agreements with the plaintiff that disclaimed the existence of a partnership. The plaintiff's lawyers summed up their argument by showing the jury a picture of a duck with a sign hanging around its neck that said "NOT A DUCK." Based on the statutory factors considered under Texas law to determine whether a partnership has been created, the jury found that there was a partnership. The jury also found that the defendant breached its duty of loyalty as that duty is defined in the BOC. The case is on appeal to the Dallas Court of Appeals.

Although some of the press coverage of the *Energy Transfer Partners* case indicates that it was based on a novel legal theory, cases of this genre are actually quite common. Opinions by the Texas courts of appeals and by federal courts applying Texas law address the question of whether a partnership has been created under the five-factor statutory test on a regular basis. Recent cases addressing this issue include: *Shafipour v. Rischon Dev. Corp.*, No. 11-13-00212-CV, 2015 WL 3454219 (Tex. App.–Eastland May 29, 2015, no pet. h.); *In re Hassell 2012 Joint Venture and Springwoods Joint Venture*, No. 15-30781, 2015 WL 2265414 (Bankr. S. D. Tex. May 12, 2015); *Eagle TX I SPE LLC v. Sharif & Munir Enters., Inc.*, 602 Fed. App'x 576 (5th Cir. 2015); *Derrick Petroleum Servs. v. PLS, Inc.*, Civil Action No. H-14-1520, 2014 WL 7447229 (S.D. Tex. Dec. 31, 2014); *In re Cavu/Rock Props. Project I, LLC*, 516 B.R. 414 (Bankr. W.D. Tex. 2014); *Box v. Dallas Mexican Consulate Gen.*, Civil Action No. 3:08-cv-1010-O, 2014 WL 1012449 (N.D. Tex. Mar. 14, 2014); *MetroplexCore, L.L.C. v. Parsons Transp., Inc.*, 743 F.3d 964 (5th Cir. 2014); *Reservoir, Inc. v. Truesdell*, 1 F.Supp.3d 598 (S.D. Tex. 2014); *Strickland Grp., Inc. v. Pathfinder Exploration, LLC*, No. 02-12-00187, 2013 WL 4773363 (Tex. App.–Fort Worth Sept. 5, 2013, no pet.); *Protocol Techs., Inc. v. J.B. Grand Canyon Dairy, LP*, 406 S.W.3d 609 (Tex. App.–Eastland 2013, no pet.); *Chapman Custom Homes, Inc. v. Dallas Plumbing Co.*, No. 05-12-00132-CV, 2013 WL 4478187 (Tex. App.–Dallas Aug. 2013), rev'd on other grounds, 445 S.W.3d 716 (Tex. 2014) (per curiam); *Citrin Holdings, LLC v. Minnis*, No. 14–11–00644–CV, 2013 WL 1928652 (Tex. App.–Houston [14th Dist.] 2013, pet. denied); *Advanced Nano Coatings, Inc. v. Hanafin*, 478 Fed. App'x 838 (5th Cir. 2012); *Malone v. Patel*, 397 S.W.3d 658 (Tex. App.–Houston [1st Dist.] 2012, pet. denied); *Rojas v. Duarte*, 393 S.W.3d 837 (Tex. App.–El Paso 2012, pet. denied); *Sewing v. Bowman*, 371 S.W.3d 321 (Tex. App.–Houston [1st Dist.] 2012, pet. dism'd); *Garcia v. Lucero*, 366 S.W.3d 275 (Tex. App.–Houston [14th Dist.] 2012, no pet.).

The seminal case exploring the issue of whether a partnership has been created under current Texas law is *Ingram v. Deere*, 288 S.W.3d 886 (Tex. 2009). In that case, the court discussed the application of the five factors set forth in the Texas Revised Partnership Act (which have been recodified without substantive change in the BOC) that indicate persons have created a partnership. The five factors are: (1) receipt or right to receive a share of profits of the business; (2) expression of intent to be partners in the business; (3) participation or right to participate in control of the business; (4) agreement to share or sharing losses of the business or liability for claims by third parties against the business; and (5) agreement to contribute or contributing money or property to the business. Courts have generally recognized that the most important factors are the sharing of profits and control over the business, but the supreme court emphasized that courts must examine the totality of the circumstances and that no single factor is determinative. Thus, labels used by the parties to describe their relationship or statements to the effect that they do or do not have a partnership are not determinative. Not all factors are required to be present, but proof of only one factor will generally be insufficient to establish a partnership. In a majority of the recent cases cited above, the party seeking to show that a partnership has been created has failed.

V. An LLC Is Not a Partnership, and Partnerships and LLCs Are Not Corporations

An LLC is not a partnership under Texas law, and an LLC is not a corporation under state law notwithstanding the irksome tendency of courts and litigants to refer to an LLC as a "limited liability corporation." If a statutory scheme confers a benefit or imposes a burden on a "corporation" or "partnership" but not an LLC, the distinction becomes significant.

A. Treatment of LLCs for Purposes of Diversity Jurisdiction

A substantial body of case law has developed in the context of the determination of the citizenship of an LLC for diversity jurisdiction purposes, and federal courts have overwhelmingly concluded that an LLC is not "incorporated" within the meaning of the federal diversity jurisdiction statute. Federal courts that have confronted and analyzed the issue (in dozens of court of appeals decisions and hundreds of district court opinions) have been virtually unanimous in concluding that an LLC's citizenship is not determined in the same manner as a corporation's citizenship for purposes of diversity jurisdiction. A corporation is deemed to be a citizen of its state of incorporation and the state where its principal place of business is located. 28 U.S.C. § 1332(c)(1). However, based on the approach to citizenship applied by the United States Supreme Court to a limited partnership in *Carden v. Arkoma Associates,* 494 U.S. 185 (1990), federal courts have consistently held that an LLC has the citizenship of each of its members. *See, e.g., Pramco, LLC v. San Juan Bay Marina, Inc.*, 435 F.3d 51 (1st Cir. 2006); *Handelsman v. Bedford Vill. Assocs., L.L.C.*, 213 F.3d 48 (2d Cir. 2000); *Zambelli Fireworks Mfg. Co., Inc. v. Wood*, 592 F.3d 412 (3d Cir. 2010); *Gen. Tech. Applications, Inc. v. Exro Ltda*, 388 F.3d 114 (4th Cir. 2004); *Harvey v. Grey Wolf Drilling Co.*, 542 F.3d 1077 (5th Cir. 2008); *Delay v. Rosenthal Collins Grp., LLC*, 585 F.3d 1003 (6th Cir. 2009); *Cosgrove v. Bartolotta*, 150 F.3d 729 (7th Cir. 1998); *GMAC Commercial Credit LLC v. Dillard Dept. Stores, Inc.*, 357 F.3d 827 (8th Cir. 2004); *Johnson v. Columbia Props. Anchorage, LP*, 437 F.3d 894 (9th Cir. 2006); *Rolling Greens MHP, L.P. v. Comcast SCH Holdings L.L.C.*, 374 F.3d 1020 (11th Cir. 2004).

Some federal courts have grown impatient with parties who fail to appreciate the well-established difference between an LLC and a corporation for purposes of establishing citizenship in a diversity case, and a party increasingly risks incurring the court's wrath and harsh treatment for this oversight. *Belleville Catering Co. v. Champaign Marketing Place, L.L.C.*, 350 F.3d 691 (7th Cir. 2003) (criticizing counsel for parties in scathing terms for treating LLC as corporation for purposes of diversity jurisdiction and ordering counsel to perform remaining services required to resolve dispute without charging parties any attorney's fees); *Allstate Ins. Co. v. Santa Ana LLC*, No. 08-60865-CIV, 2008 WL 2404822 (S.D. Fla. June 11, 2008) (dismissing action for failure to adequately allege citizenship of LLC and echoing frustration of Seventh Circuit Court of Appeals regarding lawyers' lack of familiarity with diversity jurisdiction rules); *Sterling Wholesale, LLC v. Miami-McLane Trading Corp*., No. 08-60867-CIV, 2008 WL 2404825 (S.D. Fla. June 11, 2008) (same); *Tilkin & Cagen, Inc. v. United Metal Receptacle Corp.*, No. 08 C 1564, 2008 WL 2339825 (N.D. Ill. June 4, 2008) (stating that nearly full decade had elapsed since Seventh Circuit Court of Appeals spelled out requirements for

establishing diversity of citizenship when LLC is party and that disregard of such well-established rule by plaintiff's counsel should trigger automatic dismissal); *Lexington Ins. Co. v. Gilco Scaffolding Co., LLC*, No. 08 C 2634, 2008 WL 2035760 (N.D. Ill. May 12, 2008) (same); *MB Fin. Bank, N.A. v. DirechTech Holding Co., Inc.*, No. 08 C 2524, 2008 WL 1995057 (N.D. Ill. May 6, 2008) (same). Other courts are more tolerant as they point out the error in a party's assumption that an LLC is treated in the same manner as a corporation for purposes of diversity jurisdiction. *Realco Ltd. Liab. Co. v. AK Steel Corp.*, Civil Action No. 06-131-ART, 2008 WL 1990810 (E.D. Ky. May 5, 2008). In this case, the parties did not dispute the court's subject matter jurisdiction, but the court inquired on its own as to the citizenship of the plaintiff LLC's members. Disclosure by the plaintiff revealed that complete diversity was lacking based on the rule that an LLC has the citizenship of each of its members, and the court remanded the case to state court for lack of jurisdiction. The court noted that "[i]t is common in cases like this for one to assume that limited liability companies are no different than corporations, and, thus, the pleadings often allege only the place of incorporation and principal place of business." *Id.* at *1. The court pointed out that this is an incorrect assumption and that it is well-established that an LLC has the citizenship of its members. *Id.* The court acknowledged that "it may seem illogical at first blush to treat a limited liability company differently from a corporation," but stated that "it is the job of Congress, not the courts, to fix any inconsistencies this may cause." *Id.* at *2. The court concluded almost apologetically, stating: "The Court does not take this action lightly, as it realizes the burden this action imposes on the parties. As the Court is sure the parties recognize, jurisdiction is not something with which the Court has discretion. And, in this regard, the Court appreciates the parties' diligence and assistance in determining whether jurisdiction in this matter is appropriate." *Id.*

Determination of an LLC's citizenship can be complicated by the fact that the members of an LLC may themselves be LLCs or partnerships whose citizenship in turn is determined by the citizenship of their partners or members. When there are several layers of such entities or when the partners or members of a partnership or LLC are numerous, this determination may become very challenging. The challenging nature of establishing the citizenship of such a party does not excuse the obligation to do so when diversity of citizenship is relied on for subject matter jurisdiction. In *James v. Myers*, No. 12-dv-22-DRH-SCW, 2012 WL 525583 (S.D. Ill. Feb. 16, 2012), the defendants, which included an LLC, removed the action to federal court on the basis of diversity of citizenship. In the notice of removal, the defendants alleged only the state of formation and principal place of business of the LLC. Additional briefing revealed that the LLC's sole member was another LLC whose sole member was a limited partnership. No information as to the partners of the limited partnership was provided. The defendants argued that the fact that the limited partnership was an investment fund with tens of thousands of investors made it "virtually impossible" to allege the citizenship of each of its members. The defendants urged the court to look to the state of formation and principal place of business of the LLCs and the partnership to determine citizenship, but the court stated that the Seventh Circuit had made it "abundantly clear" that the court must consider the citizenship of all the members of the defendant LLC, through the parent LLC, through all the layers of ownership of the limited partnership until the court reached only individual human beings and corporations. Because the defendants admitted that it was "virtually impossible" to allege the citizenship of the limited partnership's members, the defendants failed in their burden to show complete diversity, and the court remanded the action to state court.

Many federal district courts are now raising *sua sponte* the issue of diversity of citizenship in cases in which an LLC is a party and insufficient information to establish diversity of citizenship has been pled. *See, e.g., Wildwood Capital Asset, LLC v. Westerfield*, No. 3:12-CV-370-L, 2013 WL 357611 (N.D. Tex. Jan. 30, 2013); *Pyramid Transp., Inc. v. Greatwide Dallas Mavis, LLC*, No. 3:12-CV-0149-D, 2013 WL 840664 (N.D. Tex. Mar. 7, 2013); *Murchison Capital Partners, L.P. v. Nuance Commc'ns, Inc.*, No. 3:12-CV-4746-L, 2012 WL 5990948 (N.D. Tex. Nov. 30, 2012).

Thus far, Congress has not been inclined to step in and alter the approach taken by courts to an LLC's citizenship in regular diversity jurisdiction cases. In 2005, Congress amended the diversity jurisdiction statute with respect to class actions and included in these amendments a dual citizenship test for unincorporated associations in class action diversity cases (*see* 29 U.S.C. § 1332(d)(10)); however, Congress did not act to address the issue outside of the class action context.

B. Treatment of LLCs and Partnerships Under Section 38.001 of the Texas Civil Practice and Remedies Code (Recovery of Attorney's Fees in Breach-of-Contract Action)

Section 38.001 of the Texas Civil Practice and Remedies Code provides that "[a] person may recover reasonable attorney's fees from an individual or corporation, in addition to the amount of a valid claim and costs" if a claim is for any of eight specific categories, including a valid claim for "an oral or written contract." Thus, Section 38.001 differentiates between who may recover attorney's fees and from whom such fees may be recovered by providing that a "person" may recover attorney's fees from "an individual or corporation." The Texas Code Construction Act broadly defines "person" to include a "corporation, organization, government or governmental subdivision or agency, business trust, estate, trust, partnership, association, and any other legal entity" (Tex. Gov't Code Ann. § 311.005(2)), but neither the Civil Practice and Remedies Code nor the Code Construction Act defines the term "individual" or "corporation." The Texas Supreme Court has not defined "individual or corporation" for purposes of Section 38.001, but numerous courts have held that the terms are unambiguous and do not include unincorporated entities or organizations such as partnerships, LLCs, and unincorporated associations. *See, e.g., Greco v. Nat'l Football League*, 2015 WL 4475663, * 2-7, __ F.Supp.3d __ (N.D. Tex. 2015) (NFL is not "individual or corporation" because NFL is an unincorporated association); *Hoffman v. L & M Arts*, Civil Action No. 3:10-CV-0953-D, 2015 WL 1000838 (N.D. Tex. Mar. 6, 2015) (LLC is not "individual or corporation"); *Fleming & Assocs., L.L.P. v. Barton*, 425 S.W.3d 560, 574-76 (Tex. App.–Houston [14th Dist.] 2014, pet. denied) (limited liability partnership is not "individual or corporation"); *Ganz v. Lyons P'shp, L.P.*, 173 F.R.D. 173, 177 (N.D. Tex. 1997) (limited partnership is not "individual or corporation"). Some courts, including the Texas Supreme Court, have affirmed an award of attorney's fees against a partnership or LLC, but the interpretation of "individual or corporation" was not specifically raised in those cases. *See Baylor Health Care Sys. v. Nat'l Elevator Indus. Health Benefit Plan*, No. 3:06-CV-1888-P, 2008 WL 2245834, * 4 (N.D. Tex. June 2, 2008) ("[N]one of these cases addressed the recoverability of statutory attorney's fees from a defendant under the 'individual or corporation' language because the issue was not presented on appeal.").

C. Treatment of LLCs Under Other Texas Statutes Referring to Partnerships or Corporations

Thus far litigants and courts in Texas have largely ignored opportunities to distinguish treatment of an LLC from that of a corporation when a statute specifically speaks in corporate terms and does not address LLCs. For example, before the issue was raised and addressed in *Hoffman v. L & M Arts*, Civil Action No. 3:10-CV-0953-D, 2015 WL 1000838 (N.D. Tex. Mar. 6, 2015) (holding LLC is not "individual or corporation" for purposes of Tex. Civ. Prac. & Rem. Code § 38.001), numerous courts upheld awards of attorney's fees against LLCs in breach-of-contract actions under Section 38.001 of the Texas Civil Practice and Remedies Code without discussion of whether an LLC was an "individual or corporation." *See Howard Indus. v. Crown Cork & Seal Co., LLC*, 403 S.W.3d 347, 353 (Tex. App.—Houston [1st Dist.] 2013, no pet.); *Lee-Way Prince Enters., LLC v. QAI Assur., Inc.*, No. 01-07-01004-CV, 2009 WL3490982 (Tex. App. Houston [1st Dist.] Oct. 29, 2009, no pet.); *Hufco-Beaumont, LLC v. Johnson*, No. 14–10–01011–CV, 2011 WL 2462195 (Tex. App.—Houston [14th Dist.] June 21, 2011, no pet.); *Petro-Hunt, L.L.C. v. Wapiti Energy, L.L.C.*, No. 01–10–01030–CV, 2012 WL 761144 (Tex. App. -- Houston [1st Dist.] Mar. 8, 2012, pet. denied); *Triton 88 v. Star Elec. L.L.C.*, 411 S.W.3d 42, 65 (Tex. App.—Houston [1st Dist.] 2013, no pet.).

Another statute that litigants and courts have assumed applies in the LLC context is Section 27.01 of the Texas Business and Commerce Code. This provision defines a statutory cause of action for "[f]raud in a transaction involving real estate or *stock in a corporation or joint stock company*." Tex. Bus. & Com. Code Ann. § 27.01 (emphasis added). This provision has been relied upon in the LLC context, and it does not appear that the courts were presented with the argument that the statute does not apply to a transaction involving a membership interest in an LLC because a membership interest in an LLC is not stock in a corporation or joint stock company. *See Energy Maint. Servs. Grp. I, LLC v. Sandt*, 401 S.W.3d 204 (Tex. App.–Houston [14th Dist.] 2012, pet. denied); *Allen v. Devon Energy Holdings, L.L.C.*, 367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm't vacated w.r.m.); *Roustan v. Sanderson*, No. 02-09-00377-CV, 2011 WL 4502265 (Tex. App.–Ft. Worth Sept. 29, 2011, pet. denied).

In *SJ Medical Center, L.L.C. v. Estahbanati*, 418 S.W. 3d 867 (Tex. App.–Houston [14th Dist.] 2013, no pet.), a Texas LLC argued that it was a "hospital district management contractor" within the meaning of a provision of the Texas Health and Safety Code that treats a hospital district management contractor as a governmental unit for purposes of the Texas Tort Claims Act. The Health and Safety Code defines a "hospital district management contractor" as "a nonprofit corporation, partnership, or sole proprietorship that manages or operates a hospital or provides services under contract with a hospital district that was created by general or special law." The LLC admitted it was an LLC but argued that the undefined term "partnership" in the statute should be construed broadly to include LLCs that elect to be taxed as partnerships for tax purposes under Texas and federal law. The court concluded that an LLC does not fall within the ordinary meaning of "partnership" even if the LLC elects partnership tax treatment. The court explained that an LLC has some characteristics of a partnership but also has some characteristics of a corporation. The Legislature chose to make only nonprofit corporations, partnerships, and sole proprietorships eligible for the protections of a hospital district management contractor, and the court stated that it was not the role of the court to question the wisdom of the statute or rewrite it. The court noted that the LLC at issue had converted from a limited partnership in 2006 and had existed as an LLC since the date of the conversion pursuant to the conversion provisions of the BOC (which provide that the converted entity continues to exist without interruption in the organizational form of the converted entity rather than in the organizational form of the converting entity). The case is a cautionary tale with respect to the possible impact of a conversion under specific statutory, regulatory, or contractual provisions that may distinguish among particular types of entities.

VI. Suits Against General Partners After Judgment Against Partnership

In *American Star Energy and Minerals Corporation v. Stowers*, 457 S.W.3d 427 (Tex. 2015), the Texas Supreme Court relied on the current statutory treatment of a partnership as an entity and the legislative scheme addressing enforcement of a partnership obligation to conclude that the cause of action against a partner based on the partner's personal liability for a partnership obligation does not accrue until a creditor can proceed against a partner's assets (i.e., generally ninety days after entry of the judgment or expiration of any stay of execution). A creditor of the partnership need not join the partners in the suit against the partnership and, after obtaining a judgment against the partnership, may sue the partners in a subsequent suit even though the statute of limitations has run on the claim underlying the judgment. In such a suit, the only issues will be whether the judgment exists and whether the partners were in fact partners at the time of the injury alleged. The partners will not be entitled to relitigate the elements of the claim underlying the judgment against the partnership.

In *American Star Energy and Minerals Corporation v. Stowers*, 457 S.W.3d 427 (Tex. 2015), the appellant ("American Star") obtained a judgment against S & J Investments, a Texas general partnership, after protracted litigation spanning a decade and a half. When the judgment could not be satisfied through the assets of the partnership, American Star sued the individual partners of S &J Investments. The cause of action on which the judgment against the partnership was based obviously accrued more than four years before the partners were sued individually, but American Star argued that its suit against the partners was timely because it sued the partners within four years of the date of the judgment. The partners argued that they had to be sued within the same limitations period applicable to the underlying breach-of-contract claim against the partnership, and a divided court of appeals agreed. The Texas Supreme Court reversed.

After pointing out the statutory treatment of a partnership as an entity and a partnership's ability to enter into contracts, sue, and hold property in its own name, the court acknowledged that the personal liability of a partner for all obligations of a partnership is an aggregate-theory feature that distinguishes a partnership from other entity types. However, the court stated that the statute imposes an entity aspect on this aggregate feature in the provisions addressing enforcement of liability. The statute provides that a judgment against a partnership is not by itself a judgment against a partner. Tex. Bus. Orgs. Code Ann. § 152.306(a). A creditor must obtain a judgment against a partner individually, which the creditor may do in the suit against the partnership or a separate suit. Tex. Bus. Orgs. Code Ann. §§ 152.305, 152.306(b). In addition, a creditor may not seek satisfaction of a judgment against a partner unless a judgment is also obtained against the partnership and that judgment remains unsatisfied for ninety days. Tex. Bus. Orgs. Code Ann. § 152.306(b). Despite these provisions defining the relationship between a partner and the partnership and controlling the circumstances under which

a partner's liability may be enforced, the Legislature did not explicitly dictate when a suit against a partner may be brought. In light of a partnership's separate entity status and the statutory prerequisites to proceeding against a partner, the court held that the cause of action against a partner does not accrue until a creditor can proceed against a partner's assets.

The court explained that, as a result of the entity theory, a partner's liability is wholly derivative of the partnership's liability, and the prerequisites to enforcement make the partner's liability contingent as well. Thus, "the only obligation for which a partner is really responsible is to make good on the judgment against the partnership, and generally only after the partnership fails to do so." According to the court, the Legislature must have contemplated that some suits would be brought outside the original limitations period when it authorized a creditor to bring suit against a partner in a separate suit. The court acknowledged that American Star could have named the partners in the original suit, but the court pointed out that doing so would not have changed the result since American Star would not have been able to pursue the partners' assets until after the judgment was finalized.

The court insisted its holding did not disturb the policy purposes behind limitations and did not undermine due process. The policy purpose to compel exercise of a right of action within a reasonable time is served because the underlying cause of action against the partnership must be brought within the statute of limitations applicable to that claim. The court explained that the right to collect the judgment debt against the partners does not require relitigation of that claim; the only issues will be whether the judgment exists and whether the partners were in fact partners at the time of the injury alleged. The partners are not subject to "automatic" liability that undermines their due-process rights because they must still be personally named in an action to establish their liability, and they have the same opportunity to contest their liability as they would have had if they had been sued within the underlying limitations period. The court stated that the partners were on notice of their potential liability when they agreed to form and do business as a partnership. In addition, the partnership form provides mechanisms to provide further notice of a potential liability because a partner has a right to manage and conduct the business, which would include litigation that becomes part of the business. The court also pointed out that each partner owes the other partners a duty of care under the statute, and the court stated that this duty may require the partner served to apprise the other partners when a partnership is served with a lawsuit (citing *Zinda v. McCann St., Ltd.,* 178 S.W.3d 883, 890 (Tex. App.–Texarkana 2005, pet. denied) for the proposition that "'[p]artners have a duty to one another to make full disclosure of all matters affecting the partnership....'"). Finally, the court pointed out that partners can agree to provide notice of pending litigation to one another in their partnership agreement.

Although the court addressed this issue in the context of a general partnership, the same rationale would apply to suits against the general partner(s) of a limited partnership by virtue of Tex. Bus. Orgs. Code Ann. §§ 152.304-152.306, 153.003, 153.152.

VII. Standing of Partnership or LLC to Enforce Partnership Agreement or Company Agreement to Which Partnership or LLC is not a Signatory

The question sometimes arises whether a partnership or LLC may enforce or is bound by obligations under its partnership agreement or company agreement where the partnership or LLC itself is not a party or signatory to the partnership agreement or company agreement. (Although the partners or members typically execute the partnership agreement or company agreement, the partnership or LLC usually is not listed as a party or signatory.) A couple of recent cases in Texas have permitted a partnership or LLC to enforce an arbitration clause in its partnership agreement or company agreement even though the partnership or LLC was not a signatory to the agreement.

In *Elkjer v. Scheef & Stone, L.L.P.*, 8 F.Supp.2d 845 (N.D. Tex. 2014), the plaintiff, a partner in the defendant law firm, sued the firm for alleged gender-based discrimination in violation of state and federal statutes. The firm moved the court to stay the action and compel arbitration based on an arbitration clause in the partnership agreement between the plaintiff and the firm's other individual partners. The plaintiff argued that there was no agreement to arbitrate between the parties because the firm was not a party to the partnership

agreement. The plaintiff relied on several cases for the proposition that the court should deny the motion to compel arbitration based on "the simple fact that [the firm] did not sign its own operating agreement." The court stated that none of these cases involved LLPs, and none were decided by Texas courts or addressed Texas law. The court agreed with the firm that Texas partnership law and the language of the partnership agreement led to the conclusion that the firm was a party to its partnership agreement. The court did not view the fact that the firm was not a signatory to the partnership agreement as fatal. The court described the partnership agreement as a "master agreement" that addressed much more than just the plaintiff's relationship with the other partners. The agreement governed "the very existence and operation of the limited liability partnership." The court pointed out that Section 152.002(a) of the BOC provides that, subject to exceptions not applicable in this case, "'a partnership agreement governs the relations of the partners *and between the partners and the partnership*.'" The court read this language to encompass the partnership as a party to the partnership agreement. The court rejected the plaintiff's argument that the following language in the arbitration clause limited its scope to individual partners: "'Each party, by signing this agreement, voluntarily, knowingly, and intelligently waives any right such party may otherwise have to seek remedies in court or other forums, including the right to jury trial.'" The court viewed this sentence as merely a reaffirmation that the signatories were waiving their rights to seek remedies in any other forum. The entire clause clearly stated that it applied to "'any disputes arising under or in connection with this Agreement.'" The court found further statutory support for its conclusion in Section 152.211(a)-(b) of the BOC, which provides that both a partner and the partnership may maintain an action against the other for breach of the partnership agreement. In addition, the court pointed out that the partnership agreement contained a provision that referred to remedies of the partnership against a partner who breached any provision of the agreement. Thus, based on provisions of the BOC addressing partnership agreements in general as well as the partnership agreement at issue in this case, the court concluded that the firm was a party to the partnership agreement such that there was a valid agreement to arbitrate between the plaintiff and the firm.

In *Seven Hills Commercial, LLC v. Mirabal Custom Homes, Inc.*, 442 S.W.3d 706 (Tex. App.–Dallas 2014, pet. denied), the court of appeals addressed an LLC's claims against one of the members and an individual who signed the operating agreement as representative of that member and allegedly participated in the member's breach of fiduciary duty and tortious interference with the operating agreement. The court determined that the member and the individual (whose acts at issue were taken in a representative capacity for the member) clearly agreed to allow the arbitrator to decide the arbitrability of the claims and that the LLC could compel arbitration of its claims even though it was not a signatory to the operating agreement. The court relied on *Elkjer v. Scheef & Stone, L.L.P.* in deciding that the LLC could enforce the arbitration clause in the operating agreement even though it was not a signatory. The operating agreement, like the partnership agreement in *Elkjer*, created an ongoing relationship between the signatories and the entity and governed the operation and existence of the entity. The court pointed out that the BOC provides that the company agreement of an LLC governs "'the relations among members, managers, and officers of the company, assignees of membership interests in the company, and the company itself.'" Tex. Bus. Orgs. Code Ann. § 101.052(a). The court interpreted this provision to mean that the company agreement governs the relationships between the LLC and its members, and the court did not believe that the LLC was required to sign the operating agreement in order to enforce the arbitration provision in the agreement.

Delaware LLC cases are in accord with the results reached in the above cases. *See Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286 (Del. 1999); *Seaport Vill. Ltd. v. Seaport Vill. Op. Co., LLC*, C.A. No. 8841-VCL, 2014 WL 4782817 (Del. Ch. Sept. 24, 2014). However, there are cases in other jurisdictions reaching contrary results. *See Trover v. 419 OCR, Inc*., 921 N.E.2d 1249 (Ill. App. 2010); *Bubbles & Bleach, LLC v. Becker*, No. 97 C 1320, 1997 WL 285938 (N.D. Ill. May 23, 1997).