

**CASE LAW UPDATE:  
A SURVEY OF RECENT TEXAS  
PARTNERSHIP AND LLC CASES**

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# Case Law Update: A Survey of Recent Texas Partnership and LLC Cases

Elizabeth S. Miller

## I. Introduction

This paper summarizes recent Texas cases involving issues of partnership and limited liability company law. This paper only includes cases that have appeared since the paper for last year's program was prepared. The cases included in this paper will be added to lengthier case law surveys that include cases from prior years, and those surveys will be accessible on the author's profile page at the Baylor Law School web site.

## II. Recent Texas Cases Involving Partnerships

### A. Creation/Existence of General Partnership

*Shafipour v. Rischon Development Corporation*, No. 11-13-00212-CV, 2015 WL 3454219 (Tex. App.–Eastland May 29, 2015, no pet. h.) (mem. op.).

Nasser Shafipour sued Rischon Development Corporation (“Rischon”), asserting various claims in connection with a real estate development deal that did not come to fruition. Rischon sued Shafipour and claimed that Rischon and Shafipour formed a partnership with respect to a tract of land owned by NMV, Inc. (“NMV”), a corporation in which Shafipour was an officer and shareholder, and that Shafipour breached fiduciary duties owed to Rischon. The jury found that Shafipour and Rischon formed a partnership for the real estate transaction in question and that Shafipour breached his fiduciary duty. The court of appeals examined the evidence as to the five factors used to determine the existence of a partnership and concluded that there was no evidence that Rischon and Shafipour, individually, formed a partnership. To the extent there was evidence of the formation of a partnership, the evidence pointed to a partnership between Rischon and NMV rather than Shafipour.

The court of appeals relied on the Texas Revised Partnership Act because the events in question occurred while that statute was in effect. The court noted that a partnership is created when two or more persons associate to carry on a business for profit as owners regardless of what the association is called, and a partnership can be formed through an oral or written agreement. Whether a partnership exists is determined by the totality of the circumstances with regard to five statutory factors. The jury charge in this case set forth the five statutory factors: (1) receipt or right to receive a share of profits of the business; (2) expression of an intent to be partners in the business; (3) participation or right to participate in control of the business; (4) sharing or agreeing to share losses of the business or liability for claims by third parties against the business; and (5) contributing or agreeing to contribute money or property to the business. The trial court also instructed the jury that an agreement to share losses is not necessary to create a partnership and that a representation or other conduct indicating that a person is a partner with another partner, if that is not the case, does not itself create a partnership. The court noted that more than one factor is ordinarily necessary to establish a partnership, and the first and third factors are the most important.

The court of appeals examined the evidence in light of the five factors and concluded that there was no evidence to support the jury's finding of a partnership between Rischon and Shafipour. Although there was some evidence that Rischon and NMV's representative may have agreed to share profits, there was no evidence that Rischon and Shafipour, individually, agreed to share profits, liability, or losses. Rischon never contributed money or other property to the alleged partnership, and the evidence showed that Rischon demanded that the property be sold to Rischon before the development began. Neither NMV nor Shafipour ever signed the proposed sales contract sent by Rischon to NMV. The speech, writings, and conduct of Rischon pointed to only one conclusion regarding the intent to form a partnership: Rischon intended to partner with NMV, the property owner, and not with Shafipour as an individual. Thus, the court of appeals held that there was no partnership between Rischon and Shafipour and no fiduciary duty owed or breached by Shafipour.

*Trinh v. Elmi*, No. 01–14–00204–CV, 2015 WL 3424373 (Tex. App.–Houston [1<sup>st</sup> Dist.] May 28, 2015, no pet. h.) (mem. op.).

Trinh sued Elmi alleging claims related to an alleged oral partnership agreement. Trinh alleged that Elmi agreed to sell Trinh a 40% interest in her pharmacy for \$30,000. According to Elmi, although she and Trinh discussed the possibility of his purchasing 40% of her pharmacy for \$30,000, they never entered into an agreement. Elmi testified that Trinh paid her \$10,000 but that she later returned the \$10,000 to him. The jury found that Elmi agreed with Trinh that he would own a 40% interest in her pharmacy and that Elmi failed to comply with this agreement, but the jury found no damages for breach of contract. The jury awarded a small amount of damages on Trinh’s quantum meruit claim.

On appeal, Trinh contended that the trial court erred in rendering judgment on the jury's verdict awarding him no damages on his breach-of-contract claim and no attorney's fees based on this claim. He argued that the jury found that a partnership agreement existed and that Elmi breached that agreement. Because Trinh's expert witnesses provided uncontroverted testimony regarding Trinh's damages and attorney's fees, Trinh argued that the jury's award of no damages or attorney's fees was outside the range of evidence or against the great weight and preponderance of the evidence. The parties disputed the meaning of the jury's answers to the questions in the jury charge. Trinh contended that the jury's answers to the first two questions clearly demonstrated that the jury found that a partnership agreement existed and that Elmi breached it. Elmi argued that the jury's answers to those questions represented a finding that the parties had agreed to form a partnership but that a partnership agreement was never consummated. The court of appeals concluded that the jury's answers, while seemingly conflicting, were not irreconcilable. Trinh testified that he entered into an agreement with Elmi under which he was to pay Elmi \$30,000 for a 40% ownership interest in the pharmacy, but he only paid Elmi \$10,000, and Elmi never conveyed the interest in the pharmacy to him. The jury found that the parties had reached an agreement that Trinh would own a 40% interest in the pharmacy, but the jury was never asked about Trinh's concomitant obligations under the agreement. Although the jury found that Elmi breached the agreement, presumably when she failed to convey the ownership interest to Trinh, the jury could also have found that a partnership was never created because Trinh did not perform his obligations under the agreement. Thus, the jury could have determined that there was an agreement and that Elmi breached the agreement but that Trinh was not entitled to damages because he did not perform his obligations under the agreement. Thus, the trial court did not err in rendering judgment on the jury's verdict.

*BV Energy Partners, L.P. v. Cheatham*, No. 05-14-00373-CV, 2015 WL 2205682 (Tex. App.–Dallas May 12, 2015, no pet. h.).

BV Energy Partners, LP and BV Real Estate Management, Inc. (collectively “BV”) sued Richard Cheatham, alleging that BV and Cheatham formed a partnership to invest in the Marcellus Shale and that Cheatham breached his fiduciary duty to BV by taking BV’s money and investing it in deals without BV. BV claimed that Cheatham owed BV a share of the profits from the Marcellus Shale in excess of \$21 million. The jury answered the question inquiring whether BV and Cheatham formed a partnership in the negative, and BV complained on appeal about the wording of the jury question. The court of appeals found that the trial court did not err in the wording of the question.

In 2004, BV and Cheatham formed an LLC to invest in oil and gas interests. Cheatham was the managing member of the LLC, and the LLC’s regulations had an exclusivity provision that required Cheatham to devote 100% of his time during normal work hours to the LLC’s business and prohibited Cheatham from entering into any oil and gas ventures with anyone other than a member of the LLC. That LLC invested in only one deal, and the regulations were then amended to delete the exclusivity provision in 2007 when the LLC owned no assets and was being dissolved. In the years following formation of the LLC, Cheatham brought oil and gas investment opportunities to BV, and BV invested in some of them. In 2007, the parties had some communications regarding opportunities to invest in the Marcellus Shale, and BV furnished Cheatham funds to invest in certain projects. Over the next few years, Cheatham acquired and sold leases in the Marcellus Shale resulting in millions of dollars in profits. BV periodically asked for information but was not satisfied with Cheatham’s explanations. BV sued Cheatham and alleged that BV had formed a partnership with Cheatham to invest in the Marcellus Shale and that BV was entitled to more than \$21 million. Cheatham denied that it had a partnership with BV to invest in the Marcellus Shale and claimed that BV invested in only three leases. Cheatham calculated BV’s share of those leases as between \$1.6 million and \$2.5 million and tendered \$2.5 million. BV initially claimed that Cheatham was obligated to bring BV the Marcellus Shale opportunities under the exclusivity provision in the LLC regulations,

but BV abandoned that claim at trial. The jury was asked if BV and Cheatham created a partnership to invest in “all deals in the Marcellus Shale Play that Cheatham had an opportunity to acquire,” and the jury answered no. BV argued that the trial court erred in using the word “all” and that it should have been “any.” The court of appeals reviewed the evidence and concluded that BV presented an “all or nothing” theory with regard to its share of the profits. BV did not present any evidence of damages other than the \$21 million it claimed it was due as its share of the profits from all investments in the Marcellus Shale. Thus, the court of appeals concluded that the trial court did not err in the phrasing of the jury question.

*In re Hassell 2012 Joint Venture and Springwoods Joint Venture*, Case No. 15-30781, 2015 WL 2265414 (Bankr. S. D. Tex. May 12, 2015).

The bankruptcy court analyzed whether a construction joint venture agreement constituted a general partnership under Texas law in order to determine whether an involuntary bankruptcy petition could be filed against it. The court applied the five-factor statutory test and concluded that the joint venture agreement was a general partnership under Texas law.

Several entities owned and controlled by members of the Hassell family entered into a “Construction Joint Venture Agreement” for the stated purpose of performing public and private sector construction projects. The agreement specified the percentages in which profits and losses would be shared and in which capital would be provided, that decisions would be made by mutual agreement, that books and records would be maintained by one of the venturers and open for inspection by all venturers, that the venture would not file its own tax returns, and that the venturers had a duty to disclose opportunities to each other and were not permitted to take a venture opportunity for its own benefit. The court noted that “an association of two or more persons to carry on a business for profit as owners creates a partnership” and that the Texas Business Organizations Code sets forth five factors for determining whether a partnership has been created: (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. No one factor is dispositive, and an agreement to share losses is not required. The court concluded that the facts of this case unambiguously established the existence of a general partnership.

The first factor was firmly established because profit sharing was required by the terms of the joint venture agreement and recognized in the joint venture audit report. The court stated that the second factor was neutral to slightly negative. Although the parties used the term “joint venture” in their written agreement, they informed third parties when they entered into a contract that they would receive the devoted services of the venturers, and the joint venture did not file a partnership information return with the IRS. The joint control factor favored the finding of a partnership because the joint venture agreement clearly contemplated sharing in the right to make executive decisions and provided that all records were open for inspection by the joint venturers. The joint venture agreement specifically provided for the sharing of losses, and this factor thus favored the finding of a partnership. The fifth factor disfavored the finding of a partnership because there was scant evidence that any venturer contributed anything of value without expecting direct compensation. Each of the venturers allowed their equipment to be used, but the use was compensated at market rates. The court recognized profit sharing and joint control as the two most important factors, and these factors were clearly established. Based on the factors set forth in the Texas Business Organizations Code, the court concluded that the joint venture agreement at issue was a general partnership under Texas law, and an involuntary bankruptcy petition could thus be filed against it.

*Eagle TXI SPE LLC v. Sharif & Munir Enterprises, Inc.*, 602 Fed. App’x 576 (5<sup>th</sup> Cir. 2015).

The plaintiff brought suit in federal court to collect on delinquent notes acquired from the FDIC as receiver of a failed bank. The defendant argued that diversity jurisdiction was lacking based on an alleged partnership between the FDIC and the plaintiff. Applying the statutory five-factor test for determining the existence of a partnership, the district court concluded that the agreements entered into between the FDIC and the plaintiff’s parent company resulted in a partnership between the FDIC and the plaintiff. Because the FDIC is a federally chartered (i.e., “stateless”) corporation whose presence in a suit destroys diversity, the district court dismissed the suit. The Fifth Circuit Court of Appeals concluded that the district court erred in interpreting the agreements with respect to the FDIC’s control over the business and that the sole factor potentially indicating the existence of a

partnership—the sharing of losses—was insufficient to create a partnership in this case. Thus, the court of appeals reversed the district court.

When Colonial Bank failed, Branch Banking & Trust Company (“BB&T”) acquired certain assets and liabilities of Colonial Bank from the FDIC as receiver pursuant to a purchase and assumption agreement (“PAA”) and loss-sharing agreement (“LSA”). Included in the assets acquired by BB&T were secured notes owed by the defendants to Colonial Bank. BB&T transferred the notes and related loan documents to the plaintiff, a wholly owned subsidiary of BB&T. After the notes became delinquent, the plaintiff foreclosed on the collateral and filed this suit to collect the deficiency amounts allegedly owed on the notes. The plaintiff relied on diversity jurisdiction, and the defendants sought dismissal based on an alleged partnership between the plaintiff and the FDIC, a federally chartered corporation whose presence would destroy diversity. The defendants argued that the terms of the PAA and LSA between BB&T and the FDIC created a partnership between those parties, and the district court agreed.

The district court relied on the five factors enumerated in the Business Organizations Code 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. The district court concluded that BB&T and the FDIC did not share profits, that they did not express an intent to be partners, and that the FDIC did not contribute any money or property to the alleged partnership. However, the district court found that there was a partnership based on the sharing of losses (which was not disputed) and the FDIC’s control under the PAA and LSA.

The court of appeals reviewed the guidance provided by the Texas Supreme Court in *Ingram v Deere*, noting that the most important factors will probably continue to be the sharing of profits and control over the business and that conclusive evidence of only one factor will normally be insufficient to establish a partnership. The court of appeals agreed with the district court that there was no evidence of profit sharing or expression of an intent to be partners, and the parties did not contest that the FDIC did not contribute money or property to the business. The sharing of losses was explicitly provided by the PAA and LSA, which provided that the FDIC would reimburse BB&T for 80% of any losses incurred by BB&T on the assets acquired from the FDIC. Thus, the focus of the court’s analysis was the sharing of control.

The court of appeals disagreed with the district court’s conclusion that the FDIC had the right to participate in the control of the business under the provisions of the PAA and LSA. Although the district court set out the correct legal standards in this regard, the district court misinterpreted the provisions of the PAA and LSA granting the FDIC certain oversight authority. The court of appeals concluded that the agreements gave the FDIC reasonable oversight authority to ensure that BB&T carried out its responsibilities under a contract between two unrelated parties. Such control did not rise to partnership-level control. Because the FDIC would bear 80% of the losses, it was unsurprising it would want the ability to access and audit BB&T’s books. Further, the court of appeals did not agree that the standard of care set forth in the agreements equated to a partner’s duty of care under Texas law. The standards set out in the PAA and LSA were “intended to limit the FDIC’s liability under the 80% reimbursement scheme, not establish an across-the-board fiduciary duty.” The court stated that there would be no need to set out the specific, more limited restrictions found in the PAA and LSA if the parties had established a partnership because the law would supply broad standards of care. Finally, the court explained that all of the provisions cited by the district court as establishing the FDIC’s control over BB&T’s everyday operations were, like the oversight provisions, merely intended to protect the FDIC in light of its liability for losses. The provisions did not give the FDIC the right to make executive decisions over BB&T’s day-to-day business, and BB&T generally had the freedom to run its business profitably in whatever manner it wished. The provisions simply gave the FDIC the ability to protect itself from unnecessary losses. Thus, the provisions signified a “prudent contract” rather than a partnership.

Because the only partnership factor present in the case was the sharing of losses, the court of appeals held that no partnership was created. The court noted that the Texas Supreme Court has said that even conclusive evidence of only one factor is normally insufficient to show the existence of a partnership, and the most important factors are profit sharing and control. The court stated that loss sharing “is an ambiguous factor which is not a hallmark of partnership formation under Texas law.”

***Derrick Petroleum Services v. PLS, Inc.***, Civil Action No. H-14-1520, 2014 WL 7447229 (S.D. Tex. Dec. 31, 2014).

In 2009, Derrick Petroleum Services (“Derrick”) and PLS, Inc. (“PLS”) agreed to work together to develop and market a jointly branded database on the oil and gas industry pursuant to a Memorandum of Understanding (the “MOU”) that provided for an initial five-year term. The MOU did not specify who owned the jointly branded database, and the parties disputed each other’s rights with respect to the database. PLS argued, inter alia, that the parties formed a partnership. Derrick sought a declaratory judgment that it did not form a partnership with PLS and that it owned the database. Both parties argued that the other prematurely exited the MOU and triggered penalty provisions. The court analyzed whether the parties formed a partnership under the five-factor statutory test and concluded that the presence of two factors to a limited extent was insufficient in this case to establish the existence of a partnership.

The court set forth the description of a partnership as “an association of two or more persons to carry on a business for profit as owners” as well as the five factors that indicate the existence of a partnership under the Texas Revised Partnership Act: (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) sharing or agreeing to share losses of the business or liability for claims by third parties against the business; and (5) contributing or agreeing to contribute money or property to the business. Courts consider the totality of the circumstances, with no one factor being determinative. The court then analyzed the parties’ relationship as it related to each of the five factors.

There was some evidence of expression of an intent to be partners because the MOU used partnership vocabulary to describe their relationship. The MOU stated that the parties intended to work together as “joint venture partners.” The parties agreed in the MOU that they intended a long-term relationship for the “partnership,” but the MOU set an initial term of five years. The MOU set a target date in 2009 for the parties to formalize a written joint venture agreement, but the parties did not do so. The MOU provided that the parties would form a separate LLC if annual revenue reached \$2 million. Although the target revenue was reached in 2013, the parties were unsuccessful in negotiating the terms of an LLC. In addition to the language in the MOU, the parties referred to themselves as “partners” in email correspondence and joint press releases. Although a PLS representative testified that he meant “business associate” when he used the term “partner,” the court found the testimony on this point was not credible. The court concluded that there clearly was some evidence that the parties intended to form a long-term partnership or joint venture relationship when they drafted and signed the MOU and in its early stages. The court concluded that the evidence on this factor was limited, however, because the parties took only the concrete actions necessary to jointly brand and market the database, and no more. The court rejected PLS’s argument that Derrick was estopped to argue that it did not enter into a partnership. The court cited Tex. Bus. Orgs. Code § 152.051 for the proposition that “the intent of the parties and the words they use to describe their relationship do not determine whether a partnership exists.” PLS and its representatives were experienced in business and presumed to know Texas law, and their reliance on a representation that the parties were partners was not reasonable given PLS’s participation in negotiating and signing the MOU.

The court analyzed the parties’ division of profits, revenues, costs, and losses and concluded that the parties did not agree to, and did not, share profits, losses, or liability to third parties. The MOU provided that total or gross revenues were equally shared and that each party bore its own costs for the work it did under the MOU, and that is how the parties operated. Derrick paid the expenses it incurred in improving and maintaining the database, and PLS paid the expenses it incurred in marketing the database. PLS divided and distributed the gross revenues, and on occasions when PLS deducted certain expenses from Derrick’s share of the revenue before sending Derrick a check, Derrick protested on the basis that the MOU required each party to bear the expenses incurred in its activities. The court pointed out that the sharing of gross revenues is not profit sharing, and the court concluded that the allocation of expenses did not constitute the sharing of either profits or losses. Each party incurred its own expenses and kept its own books, and the evidence did not show that the parties ever calculated or shared profits of the business. Although PLS shared some costs with Derrick and advanced certain expenses on Derrick’s behalf, the parties did not agree to share net losses of the business venture or liability for third-party claims against the business.

The court concluded that the parties each controlled its own business and did not participate in the control of a “shared” business. Derrick controlled the development and maintenance of the jointly branded database, and PLS controlled marketing. Each party was able to provide input and suggestions about the other’s business, but

input does not amount to control. They made few shared decisions, and neither party was authorized to make decisions binding on the other. Because the parties did not exercise “shared control over a united business entity,” the court concluded that the third factor was not present.

Finally, the court analyzed whether the parties contributed or agreed to contribute money or property to the business. The court stated that the parties’ intent is the most important factor in determining whether property is contributed to, or owned by, a partnership. PLS argued that Derrick conveyed title and ownership of the database to the parties’ business venture because the MOU provided that Derrick would “provide” the database, but the court concluded that the use and context of the word “provide” indicated it meant “furnish” rather than “convey ownership of.” The court found that the jointly branded database was not a new database, but a continuation and expansion of Derrick’s database, and Derrick retained control over the content, structure, and presentation of the database. The court concluded that both parties contributed primarily time and expenses to the business venture and that both parties contributed some property, i.e., PLS’s license to its brand and Derrick’s agreement to allow access to and use of its database for the jointly branded and marketed database. Thus, this factor was present to a limited extent.

Because only two of the five factors were present, and only to a limited extent, the court concluded that Derrick and PLS did not enter into a partnership. PLS argued that the parties were obligated under the MOU to form an LLC and continue to work together. The court concluded that the MOU did not contain the essential terms necessary to create a binding agreement to form an LLC, and the MOU thus expired by its terms in 2014 at the end of the five-year term. The issue of whether the exit mechanism of the MOU was triggered was reserved for a second phase of the trial, but the court concluded that the evidence thus far did not show that the exit mechanism was triggered.

***In re Cavu/Rock Properties Project I, LLC***, 516 B.R. 414 (Bankr. W.D. Tex. 2014).

The debtor in this bankruptcy sought a declaration that a creditor’s mechanic’s lien was invalid on the basis that the creditor was actually a partner with the debtor in the development of the property on which the lien was filed. The court held that the creditor was not a partner with the debtor under Texas law, and the property was not partnership property, but the lien was invalid on other grounds.

Cavu/Rock Properties Project I, LLC (“Cavu Rock”) owned a residential housing development in California (the “Property”), and Gold Star Construction, Inc. (“Gold Star”) entered into a Development Agreement with Cavu Rock under which Cavu Rock would provide equity and debt financing to fund the project and Gold Star would act as the general contractor to develop the lots, construct homes, and market and sell to buyers. A choice of law clause dictated that Texas law governed the agreement. Gold Star recorded a mechanic’s lien on the property in California when Cavu Rock became delinquent in paying Gold Star’s invoices for work on the Property. Cavu Rock filed for Chapter 11 Bankruptcy in the Western District of Texas and filed this adversary proceeding asking the court to declare Gold Star’s lien void and disallow its claim.

According to Cavu Rock, Gold Star’s lien was invalid because Gold Star was a partner in the development of the Property pursuant to the Texas Business Organizations Code and was thus ineligible to hold a lien on the Property. The court found Cavu Rock’s argument regarding Gold Star’s status as a partner to be unavailing. The court stated that reasonable minds could differ as to whether Gold Star and Cavu Rock formed a partnership for the development of the Property, and the court found that they did not. In any event, partnership status was not dispositive of Gold Star’s ability to have a lien on the Property because the Property belonged to Cavu Rock rather than the alleged partnership between Gold Star and Cavu Rock.

The parties agreed that the Texas Business Organizations Code (BOC) governed the Development Agreement. Under Section 152.051 of the BOC, “an association of two or more persons to carry on a business for profit as owners creates a partnership, regardless of whether: (1) the persons intend to create a partnership; or (2) the association is called a ‘partnership,’ ‘joint venture,’ or other name.” The BOC sets out the following factors indicating whether a partnership exists: (1) receipt or right to receive a share of profits of the business; (2) expression of an 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. However, “the receipt or right to a share of payment of wages or other compensation to an employee or independent contractor” does not alone create a partnership relationship. Nor does “the right to share or sharing gross returns or revenues, regardless of whether the persons sharing the gross returns or revenues have a common or joint interest in the property from



which the returns or revenues are derived.” No one factor is necessary or dispositive as to partnership status; courts must consider the totality of the circumstances. Several of the factors suggested that Gold Star and Cavu Rock formed a partnership. Gold Star had a right to 40% of the distributable net income from the Property, but “the right to share or sharing gross returns or revenues” is not alone sufficient to establish a partnership. The Development Agreement gave Gold Star some control over certain aspects of the business, including marketing and sale of the lots to end buyers, and Cavu Rock presented evidence establishing that Gold Star coordinated development of the Property along with Cavu Rock. Gold Star also shared authority to approve disbursements of the proceeds from sales with Cavu Rock. Certain actions taken by Gold Star and provisions in the Development Agreement indicated that there may be a partnership. However, the court found the factors suggesting that there was no partnership more compelling. Gold Star's control over development was limited and less extensive than Cavu Rock's control. The Development Agreement restricted Gold Star's control by requiring Cavu Rock's approval of expenditures and the critical path of development “at its sole discretion.” Neither the Development Agreement nor the conduct of the parties suggested that Gold Star was liable for debts of the business or third party claims not related to Gold Star's own activities. Gold Star did not appear to contribute capital or property, although it did assign certain rights to acquire the Property to Cavu Rock in a prior agreement. There was little evidence indicating that Gold Star expressed any intent to be a partner. In fact, the Development Agreement contained an express disclaimer of a partnership as follows: “[N]othing in this Agreement shall be construed, deemed or interpreted by the parties or by any third person to create the relationship of principal and agent or of partnership, joint venture or any other association other than that of debtor-creditor between the parties.” Gold Star was to “act as general contractor,” invoicing Cavu Rock for development expenses. It was not clear that Gold Star associated with Cavu Rock “as an owner” as contemplated by Section 152.051. The Development Agreement specifically stated that Cavu Rock was the sole owner of the Property and retained title to each lot until sold to an end buyer. In light of the totality of the circumstances, the court found that Gold Star and Cavu Rock did not form a partnership for the development of the Property.

#### **B. Partner’s Personal Liability; Partner’s Power to Bind Partnership**

*Doctors Hospital at Renaissance, Ltd. v. Andrade*, 13–15–00046–CV, 2015 WL 3799425 (Tex. App.–Corpus Christi-Edinburg June 18, 2015, no pet. h.).

A limited partnership that operated a hospital sought summary judgment arguing that it could not be held vicariously liable for the negligence of a limited partner physician’s negligence. The court held that the limited partnership failed to establish as a matter of law that it could not be liable for the physician’s negligence.

The Andrades sued Dr. Lozano, Doctors Hospital at Renaissance, Ltd. (“DHR”) and RGV Med, LLC (“RGV”), alleging that Lozano was negligent in delivering their daughter, causing permanent injury to the child. The Andrades alleged that DHR and RGV were vicariously liable for Lozano's negligence. DHR, a limited partnership, owned and operated the hospital where the delivery took place. RGV was DHR's general partner, and Lozano was a limited partner of DHR. RGV, as general partner of DHR, had “the liabilities of a partner in a partnership without limited partners to a person other than the partnership and the other partners. Tex. Bus. Orgs. Code § 153.152(b). Thus, RGV’s vicariously liability for Lozano's actions depended solely on whether DHR could be held liable. DHR moved for summary judgment, contending that it was entitled to judgment as a matter of law because Lozano “was not acting within the scope of [the] partnership” or “with the authority of the partnership” at the time of the alleged negligence. The trial court denied summary judgment but granted DHR's request to file an immediate interlocutory appeal.

The parties agreed that the governing statute was Section 152.303 of the Texas Business Organizations Code (BOC), which provides that “[a] partnership is liable for loss or injury to a person, including a partner, or for a penalty caused by or incurred as a result of a wrongful act or omission or other actionable conduct of a partner acting: (1) in the ordinary course of business of the partnership; or (2) with the authority of the partnership.” The court pointed out that the provisions of Chapter 152 (which govern general partnerships) are applicable to limited partnerships to the extent that Chapter 153 and other limited partnership provisions are silent. Tex. Bus. Orgs. Code § 153.051(d). Thus, the court assumed in accordance with the parties’ arguments that Section 153.303 applied to a limited partnership such as DHR.

The court discussed at some length the case of *Jones v. Foundation Surgery Affiliates of Brazoria County*, 403 S.W.3d 306 (Tex. App.–Houston [1st Dist.] 2012, pet. denied), in which Section 152.303 was applied in the

medical malpractice context. In that case, the court of appeals rejected the partnership's argument that it was "impossible" for one of its partners, a doctor, to have been "acting in the ordinary course" of the business of the partnership when he operated on the plaintiff because the partnership was forbidden by law from practicing medicine. The partnership in *Jones* argued that its business was merely to provide the facility, equipment, supplies, and support personnel for its partner surgeons to perform surgery, but the court of appeals pointed out that the partnership's filings with the Texas Secretary of State, as well as its own subscription agreement, stated that the partnership's business was outpatient ambulatory surgery. Thus, there was more than a scintilla of evidence that the doctor was acting in the ordinary course of the partnership's business when he operated on the plaintiff. The *Jones* court also rejected the partnership's argument that summary judgment was proper because the doctor's actions were not authorized by the partnership. The partnership contended that the doctor's actions were not authorized because the partnership was prevented by law from controlling the treatment decisions made by the doctor, and the partnership authorized only medical treatment within the scope of reasonable care. The court held that, while Section 152.055(b) of the BOC prohibits physician-partners from "exercising control over [another physician-partner]'s clinical authority granted by their respective licenses," that prohibition is limited to "treatment decisions made by the practitioner." Further, the court noted that Section 152.055(a) provides that "[p]ersons licensed as doctors of medicine ... may create a partnership that is jointly owned by those practitioners to perform a professional service that falls within the scope of practice of those practitioners." The court additionally noted that the partnership's subscription agreement expressly authorized the doctor to perform surgery on the plaintiff. Finally, the *Jones* court rejected the argument that the doctor's authorization was limited to surgeries within a reasonable standard of care, finding that, having authorized the doctor to perform outpatient surgery, the partnership was potentially liable for the manner in which the surgery was performed.

DHR's motion for summary judgment argued that Lozano was acting as an independent contractor and not a limited partner at the time of the alleged negligence. DHR further argued that, even if Lozano was acting as a limited partner at the time of the alleged negligence, he could not have been acting within the scope of the partnership because (1) DHR was prohibited by law from practicing medicine, and (2) DHR's partnership agreement provided that all medical decisions must be made by doctors who are members of the medical staff. The Andrades summary judgment response included evidence that DHR offered labor and delivery services to the public at the time of their daughter's delivery and a copy of DHR's partnership agreement, which specifically referenced the establishment of a hospital and the provision of medical services. In reply, DHR provided the subscription agreements of DHR and RGV and the "articles of incorporation" of RGV to show that the purposes of those entities did not explicitly reference the practice of medicine as did the subscription agreement in *Jones*.

The court of appeals found that there was at least an issue of fact as to whether Lozano, at the time of the alleged negligence, was either acting in the ordinary course of DHR's business or with DHR's authority. Even assuming that a limited partnership is statutorily prohibited from practicing medicine, a partner need not necessarily be acting outside the scope of the partnership's business and without the authority of the partnership when the partner practices medicine. Additionally, Section 152.303 does not require that a partnership have the legal or contractual authority to "exercise control" over a partner's actions in order for the partnership to be held liable for the partner's actions; it only requires that the partner be acting in the ordinary course of business of the partnership or with the authority of the partnership. DHR's partnership agreement explicitly stated that DHR "owns and operates" the hospital at which the alleged negligence occurred; Lozano testified that he was a partner of DHR and that one of the purposes of DHR was to provide obstetrical services; and DHR's interrogatory responses stated that DHR was offering labor and delivery services to the public at the time of the delivery of the Andrades' daughter. This was some evidence that DHR's "ordinary course of business" included the practice of medicine by its physician-partners. The court rejected DHR's attempts to distinguish *Jones* based on differences between the role of the partners and the way the partnership business was conducted in *Jones*.

DHR further argued that, under paragraph 2.4 of the partnership agreement, Lozano "was not allowed to perform any act on behalf of the partnership." Paragraph 2.4 provided as follows:

*2.4 Limited Partner Status.* The Limited Partners shall not perform any act on behalf of the Partnership; incur any expense, obligation or indebtedness of any nature on behalf of the Partnership; or in any manner participate in the management of the Partnership or receive or be credited with any amounts, except as specifically contemplated hereunder. A Limited Partner shall not be personally liable for any amounts other than the amounts contributed by such Limited

Partner to the capital of the Partnership, and shall not be liable for any of the debts or losses of the Partnership or of the General Partner, except only to the extent that a liability of the Partnership is founded on or results from an unauthorized act or activity of such Limited Partner.

The court stated that DHR's argument ignored the explicit caveat contained within paragraph 2.4—"except as specifically contemplated hereunder." Paragraph 2.4 thus did not establish as a matter of law that Lozano was not acting on behalf of DHR or with the authority of DHR at the time of the alleged negligence.

DHR argued that the "practice of medicine" clearly was not one of the purposes of DHR under paragraph 1.7 of the partnership agreement, which described its purposes. But the court pointed out that paragraph 1.7 provided that one of the partnership's purposes was "to own, develop, operate and engage in such other business activities as the General Partner may deem appropriate from time to time." Thus, paragraph 1.7 did not establish as a matter of law that the practice of medicine was not one of the purposes for which the partnership was organized. The court applied the same rationale to DHR's argument regarding the purposes stated in RGV's "articles of incorporation." Though the articles listed several purposes, the list was very broad and did not purport to be exclusive.

In sum, viewing all the evidence favorable to the Andrades as true, DHR did not establish its entitlement to judgment as a matter of law, and the trial court did not err in denying summary judgment.

*Leibovitz v. Sequoia Real Estate Holdings, L.P.*, 2015 WL 3451675, \_\_ S.W.3d \_\_ (Tex. App.–Dallas 2015, no pet. h.).

Leibovitz signed a settlement and release agreement as manager of the general partner of a limited partnership (Sequoia Frankford Springs 23, L.P. or "SFS 23") and also signed on his own behalf agreeing that he was bound by the agreement. The agreement settled a lawsuit with an entity that created real-estate investment offerings (Sequoia Real Estate Holding, LP. or "Holdings") and contained a confidentiality and non-disparagement provision in which the parties agreed not to disclose the terms and conditions of the agreement and not to make any derogatory, disparaging and/or untruthful statements about any other party. The agreement stated that violation of this provision would be a breach of the agreement and would entitle the non-breaching party to immediate injunctive relief. After Leibovitz became aware that Holdings was handling funds in a manner that he believed was improper, he threatened to file complaints with federal regulators and disclose to investors in other investments of Holdings the complaints in the lawsuit that had been settled. Holdings filed suit seeking damages and injunctive relief. The jury found Leibovitz breached the settlement agreement, and the trial court entered a judgment for damages, attorney's fees, and a permanent injunction.

On appeal, one issue addressed by the court was whether SFS 23 performed or threatened to perform a wrongful act. Leibovitz and SFS 23 argued there was no evidence SFS 23 performed or threatened to perform a wrongful act. They argued that Holdings had to show an act or threat by SFS 23 separate or independent of any threat or act by Leibovitz. The court rejected this argument, saying that limited partnerships, such as SFS 23, act only through their general partners (Tex. Bus. Orgs. Code §§ 153.102, 153.152(a)(1)), and Leibovitz was the manager of the entity that was SFS 23's general partner. Leibovitz performed or threatened to perform a wrongful act, and Leibovitz admitted at trial that he breached the agreement. There was testimony that Leibovitz threatened to communicate with the investors in other Holdings offerings about the problems in the Holdings offering in which Leibovitz was involved with Holdings. Leibovitz was the manager of SFS 23's general partner, and the trial court could have concluded Leibovitz breached the agreement in his role as manager of SFS 23's general partner as well as on his own behalf.

*Lemon v. Hagood*, No. 05-13-00132-CV, 2014 WL 3700687 (Tex. App.–Dallas July 24, 2014, no pet.) (mem. op.).

A lawyer who was hired by one partner in a law firm partnership to assist on a contingent fee case recovered against the other partner for breach of contract after the partners parted ways and the second partner waived the right to recover the contingent fee from the clients in order to serve as special counsel to the trustee in the bankruptcy of the defendant/judgment debtor in the clients' case.

Gary Carpenter and Julie Perez (the Carpenters) signed a contingency fee contract with Van Shaw of the partnership Shaw & Lemon to represent them in a suit against The Holmes Builders, Inc. ("Holmes Builders"). Shaw hired Hagood to help with the trial. Shaw and Lemon had a standing oral agreement with Hagood that they

would pay him 25% of what they received under the contingent-fee contracts with their clients on cases in which he assisted them. Eventually, the Carpenters received a judgment against Holmes Builders. While the case was on appeal, Shaw and Lemon stopped practicing together. After the trial court rendered a final judgment, Holmes Builders filed for bankruptcy protection. Lemon applied to serve as special counsel to the bankruptcy trustee, and the trustee agreed to pay him 34% of recovered assets for the estate. Lemon signed an affidavit stating that he obtained the Carpenters' consent to represent the bankruptcy estate and that he waived all claims for recovery of fees for past services provided to the Carpenters. Lemon did not tell Shaw or Hagood that he had waived all claims for recovery of fees in the Carpenters' case. Hagood sued Lemon for breach of contract. Hagood argued that he had an enforceable agreement with Shaw & Lemon for 25% of the attorney's fees received by Shaw & Lemon under the agreement with the Carpenters and that Lemon was jointly and severally liable for Shaw & Lemon's failure to pay the fees to which he was entitled. The jury found that Shaw & Lemon was a partnership, that it promised to pay Hagood for his services in the Carpenter lawsuit 25% of any recovery of attorney's fees "related to the Firm's representation in that lawsuit," and that Lemon failed to pay. On appeal, Lemon argued that he did not breach any contract with Hagood (since the firm did not recover any fees from the Carpenters) and that he did not waive the rights of the firm or Hagood, but only waived his own rights to fees from the Carpenters. But the jury found that Shaw & Lemon was a partnership that had a contract with Hagood, and (although Shaw and Lemon were no longer practicing together) Lemon presented no evidence that the Carpenters' contract was not still an asset of the partnership when Lemon filed the Carpenters' claim and took the post of special counsel to the bankruptcy trustee. The court pointed out that a partner is an agent of the partnership for the purpose of its business, and the act of a partner binds the partnership if the act is for the purpose of carrying on the partnership business, citing Tex. Bus. Orgs. Code §§ 152.301, 152.302. The court stated that a duty to cooperate is implied in every contract in which cooperation is necessary for performance, and a reasonable jury could find that Lemon failed to cooperate by waiving the fee agreement with the Carpenters and making impossible the performance of the condition precedent to liability to Hagood under the fee agreement with Hagood. Thus, the court concluded that there was evidence to support Lemon's liability for breach of contract.

### **C. Limitations in Suit Against Partners After Suit Against Partnership**

*American Star Energy and Minerals Corporation v. Stowers*, 457 S.W.3d 427 (Tex. 2015).

American Star Energy and Minerals Corporation ("American Star") obtained a judgment against S & J Investments, a Texas general partnership. 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 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.

The 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). The court noted that the parties disagreed whether the Texas Revised Partnership Act (TRPA) or the Texas Business Organizations Code (BOC) applied to this case, but the court stated that there was no substantive difference in the applicable provisions. The court referred to the TRPA but cited the provisions of the BOC for practicality's sake.

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. 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. 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. 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.

#### **D. Fiduciary Duties of Partners and Affiliates**

*Peterson v. Kroschel*, No. 01–13–00554–CV, 2015 WL 3485784 (Tex. App.—Houston [1<sup>st</sup> Dist.] June 2, 2015, no pet. h.) (mem. op.).

In this lawsuit arising out of a dispute between Peterson and Kroschel, who informally formed a 50-50 partnership to remove sand from a pit for a drainage district, Peterson sought damages from Kroschel for breach of fiduciary duty, alleging that Kroschel took more than 50% of the profits from the business. The jury found that Kroschel did not comply with his fiduciary duty, and the damages question asked the jury to find damages based on the amount of profits Kroschel retained that rightfully belonged to Peterson. The jury charge did not define profits and instructed the jury to give undefined terms their ordinary meaning. The jury awarded Peterson more than \$83,000. On appeal, Kroschel argued that the evidence did not support this amount. Peterson argued that Kroschel's testimony that he paid himself approximately \$103,000 from the partnership's bank account was sufficient to support the jury's award, but this testimony only demonstrated that Kroschel was paid a certain sum from the partnership's bank account and did not demonstrate how much of that money rightfully belonged to Peterson. Though there was testimony and damages regarding a wide range of alleged damages based on different theories and calculations, there was no evidence of the amount of profits from the partnership that rightfully belonged to Peterson and were retained by Kroschel.

*American Star Energy and Minerals Corporation v. Stowers*, 457 S.W.3d 427 (Tex. 2015).

The 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 accrues when 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) rather than

when the underlying claim against the partnership accrues. In the course of its opinion, the court pointed out that each partner owes the other partners a duty of care under the statute, and the court commented 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....”).

*Securities and Exchange Commission v. Helms*, No. A–13–CV–1036 ML, 2015 WL 1040443 (W.D. Tex. Mar. 10, 2015).

The court held that a security interest obtained by a limited partner in an oil and gas limited partnership to secure the limited partner’s investment was a fraudulent transfer under the Texas Uniform Fraudulent Transfer Act (TUFTA). The court concluded that, at the time of the limited partner’s investment, the limited partnership’s business was operated as a Ponzi scheme, which created a presumption that the grant of the security interest was made with fraudulent intent. The limited partner argued that it was entitled to protection as a good faith purchaser for value, but the court stated that the limited partner could not meet the objective test of good faith under TUFTA. The limited partner’s lack of due diligence and unreasonable reliance on a side letter with the general partner (which conflicted with some of the terms of the limited partnership agreement) did not support a showing of objective good faith. Further, the preferential treatment of the limited partner in the side letter under which the security interest was granted by the general partner on behalf of the limited partnership was a breach of the general partner’s fiduciary duty, and the side letter was void. Thus, the limited partner’s security interest did not attach under the Texas Uniform Commercial Code.

The court analyzed the enforceability of a security interest obtained by Clovis Capital Ventures, LLC (“Clovis”) when it invested in Vendetta Royalty Partners, Ltd., an oil and gas limited partnership. The limited partnership was organized and marketed as a standard limited partnership that would hold and distribute royalty interests from approximately 2,000 oil and gas wells located principally in Texas. Clovis ultimately invested \$2.885 million in the limited partnership in exchange for its limited partnership interest. In order to induce Clovis to make its investment, the general partner executed a side letter agreement in which it agreed to transfer to Clovis certain properties from the limited partnership’s portfolio upon certain “trigger events.” Pursuant to the side letter, the limited partnership executed a collateral assignment and other documents effectuating the arrangement. Eventually, the Securities and Exchange Commission filed a securities fraud action against the principals involved in the limited partnership and other entities and obtained appointment of a receiver. In this opinion, the court addressed the receiver’s motion to reject the secured claim of Clovis and sell the royalty interests Clovis claimed as collateral free and clear of all liens.

Clovis argued that it acted in good faith and as a prudent investor by collateralizing its investment as memorialized in the side letter, but the court pointed out that a comparison of the side letter and the partnership agreement revealed that the side letter violated the partnership agreement in numerous respects. First, the side letter stated that it shall be deemed an amendment to the partnership agreement, but the partnership agreement required the written consent of a majority in interest of the limited partners as well as the general partner. Second, the side letter would automatically transfer the collateral, which was partnership property, to Clovis upon a “trigger event,” but the partnership agreement provided that the property of the partnership was owned by the partnership as an entity and not by any individual partner. Third, the side letter provided that the quarterly royalty payments distributed to Clovis were in lieu of interest on the capital contribution, but the partnership agreement provided that no interest would accrue on capital contributions. Fourth, the side letter stated that the sale of the collateral was expected to provide more than adequate funds to return the full capital contribution of Clovis, but the partnership agreement stated that a limited partner was not entitled to a return of its capital contribution except by unanimous agreement of the partners or upon dissolution. Clovis argued that the partnership agreement gave the general partner full authority to incur obligations and encumber assets as well as stating that persons may rely on the authority of the general partner with no duty to inquire into the general partner’s authority. The court acknowledged these provisions but responded by stating that a general partner in a limited partnership owes a fiduciary duty to the partnership and the limited partners under Tex. Bus. Orgs. Code §§ 153.152(a), 152.204(a). The court described the duty of a general partner under Texas law as follows: “a general partner ‘acting in complete control stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of a trust.’” The court stated that construing the partnership agreement as Clovis argued would give the general partner carte blanche to ignore various provisions and to encumber assets with little consequence, and the provisions protecting the limited

partners would be completely overridden. The court declared that the side letter was void as a result of its provisions violating and attempting to amend the partnership agreement. The court agreed that some of the provisions of the partnership agreement may be contradictory, but the court stated that a comparison of the side letter and the partnership agreement would lead a reasonable transferee to believe the attempted transfer breached the general partner's fiduciary duty to the limited partners by placing Clovis ahead of other limited partners. At a minimum, the court thought that a comparison would lead a reasonable transferee to inquire into the nature of the transfer. Clovis did not conduct meaningful due diligence, and no representative explained the obvious inconsistencies between the side letter and the partnership agreement. The side letter thus did not support Clovis's argument that it acted in objective good faith. Additionally, because the court found that the side letter was void and unenforceable, Clovis' purported security interest did not attach under the Texas Uniform Commercial Code.

*Plano AMI, L.P. v. Cruz*, No. 05–12–01480–CV , 2015 WL 128592 (Tex. App.–Dallas Jan. 9, 2015, no pet. h.).

The plaintiff obtained a judgment based on the jury's finding that the plaintiff's fellow investor in a limited partnership failed to comply with his fiduciary duties to the partnership and the plaintiff with respect to the dissolution and winding up of the partnership. The court of appeals held that the jury should have been permitted to consider whether the plaintiff waived his claim for breach of fiduciary duty by consenting to dissolution of the partnership.

Cruz sued Ghani for breach of fiduciary duty in connection with the winding up of North Dallas Medical Imaging, L.P. ("NDMI"). Cruz and Ghani were limited partners in NDMI, and a corporation owned and controlled by Cruz and Ghani was the general partner. The jury found that Ghani failed to comply with his fiduciary duties to the partnership and Cruz in connection with the decision to dissolve and wind up the partnership. Ghani asserted the affirmative defense that Cruz waived the breach because Cruz consented to the dissolution, but the trial court granted Cruz's motion for an instructed verdict on this issue. On appeal, Ghani argued that the trial court erred.

Without attempting to present all the evidence bearing upon the issue of waiver, the court of appeals concluded that the record presented a fact issue as to whether Cruz waived his right to complain about the dissolution of NDMI. Ghani's waiver argument relied on the following evidence: (1) Cruz signed a consent authorizing the dissolution; (2) Cruz signed the meeting's minutes where NDMI's financial status and dissolution were discussed; (3) Cruz had knowledge of NDMI's financial demise; and (4) Cruz testified that he "went along with it." The court of appeals discussed evidence relating to the meeting of the board of directors of the corporate general partner at which the board, including Cruz, "unanimously" determined that: NDMI should be dissolved, wound up, and terminated; a recommendation should be presented to the limited partners for a vote; and Ghani as president of the corporate general partner was authorized to handle the winding up. The court also noted evidence that Cruz had knowledge NDMI could not survive in the long term and possession of the files containing the financial records of NDMI. The court concluded that more than a scintilla of evidence showed that Cruz actively participated in the decision to dissolve NDMI, with knowledge of facts concerning the challenges facing outpatient imaging centers, and this evidence raised material fact issues regarding whether Cruz intentionally relinquished a known right or acted in a manner inconsistent with claiming that right. Thus, the trial court erred in precluding the jury from considering whether Cruz's actions waived any breach of fiduciary duty related to NDMI's dissolution.

*In re Whittington*, 530 B.R. 360 (Bankr. W.D. Tex. 2014).

Limited partners in three limited partnerships sought summary judgment against the controlling manager of the general partner of each partnership, asserting that the manager breached his fiduciary duties and committed fraud by taking for himself and his associates secret "cuts" or side profits out of the purchase prices of properties acquired by the partnerships and that the manager's debt based on this conduct was nondischargeable. The court granted the plaintiff's motion for summary judgment.

Despite a "tangle of entities, individuals, and transactions" resulting in a "patina of complexity," the core of this case was relatively simple, and the parties essentially agreed on the relevant facts. Whittington was the manager of three LLCs, each of which served as general partner of a limited partnership formed to purchase real property south of Austin. In connection with the purchase of properties by each of the partnerships, Whittington and some of his associates took a large cut of each purchase price. More than 20% of each purchase price paid by the partnerships for the properties went not to the sellers but to Whittington and other third parties. Whittington and his associates originally entered into purchase agreements with the sellers of the properties, but these original

agreements were ultimately assigned to the partnerships. The partnerships then purchased the properties at a higher price, consisting of (1) the originally agreed-upon amounts, which were paid to the sellers, plus (2) the undisclosed “cuts,” paid to Whittington and his associates. Whittington sought to justify the “cuts” as a sort of finder's fee or development fee (or both) for work in identifying desirable properties and initiating development of the open land into residential subdivisions. The plaintiffs did not dispute that Whittington and his associates may have added value to the land, and the plaintiffs did not argue that finder's fees, development fees, or intermediary fees must be disclosed in all real estate transactions. Rather, the plaintiffs asserted that the extra fees should have been disclosed to them by Whittington because he was their fiduciary when the transactions took place and the cuts were taken. The plaintiffs claimed that Whittington deliberately hid the cuts from them, intending to deceive them. According to the plaintiffs, Whittington was required to return the cuts because the cuts were taken with the knowledge of and for the benefit of Whittington as their fiduciary but were not disclosed to them. The plaintiffs argued that his debt to them should be held nondischargeable under Section 523(a)(2)(A) of the Bankruptcy Code, which excepts from discharge a debt obtained by a false representation or actual fraud, and under Section 532(a)(4), which excepts from discharge a debt for fraud or defalcation in a fiduciary capacity.

The court stated that the plaintiffs were correct that Whittington was a fiduciary with respect to the limited partnerships and their limited partners and, as such, had a duty to disclose material facts about the purchases of the properties to them. The court described a managing partner's duties as “the highest fiduciary duty recognized in the law.” Further, Whittington's “one-step-removed status,” as an individual manager of the general partner of the limited partnerships, did not insulate him from this duty. Based on the complete control he exercised over the partnerships, Whittington took on a fiduciary duty to the limited partners. At the hearing, Whittington's counsel conceded that Whittington personally owed fiduciary duties to each partnership and the limited partners. The court stated that Texas law imposed on Whittington a duty to disclose all material facts concerning the purchases of the properties because “partners owe each other a duty to make full disclosure of all material facts within their knowledge relating to partnership affairs.” The evidence made clear the materiality of the side profits and the intent by Whittington to conceal the side profits. Whittington argued, however, that his fiduciary duty could not have been breached by any failure to disclose because the partnership documents were not signed until the closing on the properties and his fiduciary duties thus did not arise until at or after each closing. There was evidence that some of the properties were purchased after the signing of the partnership agreements, but even if all the partnership agreements were signed “at closing,” the court stated that Whittington could not free himself of his duties so easily. He signed all of the closing documents on behalf of the partnerships, and it was clear at each closing that Whittington had accepted and was acting in his capacity as manager of the general partner of each partnership. Regardless of when the documents were signed, the partnerships had to be effective before the purchase documents, because without a partnership there could be no purchaser. Whittington's own signature attested to his fiduciary relationship with each partnership. The court said that this case was unlike the cases cited by Whittington in which duties truly arose *after* arm's-length transactions between parties who later entered into a fiduciary relationship. The court stated that it was not springing any retroactive or unexpected duties upon Whittington. The underlying terms of each deal may have been agreed upon prior to the arising of a fiduciary relationship, but Whittington's fiduciary responsibility had arisen at the time of signing, if not before, and at that moment he had the duty to disclose all material facts about the transaction to his limited partners, including the important fact that he was making large side profits.

The court noted that there was an alternative argument that bore mentioning. The plaintiffs pointed to an unusual provision in each partnership agreement that explicitly imposed fiduciary duties on the limited partners for “exercis[ing] good faith or integrity” in their own affairs and in partnership affairs “as those affairs may relate to the acquisition, ownership, development, consulting, and/or sale (collectively, ‘Development’) of other real property.” These duties applied “to any Development of real property that any limited partners has [sic] entered into since August 1, 2003....” Whittington was the manager of the general partner of Gunn & Whittington Development I, Ltd. (“G&W”), which was a limited partner in each of the partnerships that bought the properties in the transactions at issue. The court stated that the clause was “not completely lucid, but the projects on which G & W ‘entered into’ the ‘acquisition, ownership, development, consulting, and/or sale’ after August 1, 2003 would seem to include the properties at issue here, with the possible exception of” one of the properties. Thus, insofar as the duty covered the relevant properties, it seemed clear to the court that Whittington breached this duty, and the court characterized the plaintiffs' alternative argument as “powerful.” The court stated that it need not rely on this



alternative reasoning, however, in view of its holding based on the fiduciary duty owed by Whittington through his control of the general partner.

The court addressed Whittington's knowledge of the falsity of his misrepresentations, Whittington's intent to deceive, the plaintiffs' actual and justifiable reliance, and the plaintiffs' proximately caused loss, and the court found all these elements of Section 523(a)(2)(A) were established. Whittington argued that the partnerships and limited partners could not demonstrate a "proximately caused loss" from his fraud and breach of fiduciary duty because the partnerships paid a fair price for the land even with the profits to him and his associates. Even assuming the evidence would show this, the court stated that Whittington's deceit created a debt to plaintiffs and proximately caused a "loss" for purposes of Section 523(a)(2)(A) of the Bankruptcy Code. The court pointed to a large body of Texas case law teaching that fiduciaries who profit from their self-dealing are not permitted to keep their side profits—even if damage to the party complaining of breach has not been shown. For this reason, the plaintiffs were not required to demonstrate that they suffered any further loss in order to sustain their cause of action under Section 523(a)(2)(A).

In addition to determining that Whittington's debt was nondischargeable under Section 523(a)(2)(A), the court determined that Whittington's debt was nondischargeable on the basis that it was for fraud or defalcation in a fiduciary capacity. The court addressed various defenses raised by Whittington, including lack of standing by the plaintiffs, the statute of limitations, and the equitable doctrines of fraud, unclean hands, and laches. The court rejected these defenses and granted summary judgment in favor of the plaintiffs on all these matters. The court reserved the question of damages. The amount of Whittington's nondischargeable debt, which might include awards of restitution/d disgorgement, interest, attorney's fees, and punitive damages, was to be determined at a future hearing.

***Beach Capital Partnership, L.P. v. DeepRock Venture Partners, LP***, 442 S.W.3d 609 (Tex. App.—Houston [1<sup>st</sup> Dist.] 2014, no pet.).

In litigation between the majority and minority partners of a limited partnership, the majority partner obtained a judgment against the minority partner for damages for breach of contract and breach of fiduciary duty. The court of appeals held that the evidence was sufficient to support the damages award to the partnership in the amount of a distribution made to the minority partner; awarding the damages directly to the majority partner was not error; and the evidence was sufficient to support finding that the minority partner took unauthorized bonuses.

Beach and Touradji decided to form an oil and gas limited partnership. An entity controlled by Touradji ("DeepRock"), held an 80% interest in the partnership and agreed to contribute between \$8 million and \$30 million to the partnership. An entity controlled by Beach ("Beach Capital"), held a 19.9% interest and agreed to contribute to the partnership certain oil and gas leases, seismic permits, and options to lease. Another entity controlled by Beach held the remaining 0.1% interest as the partnership's sole general partner. After the partnership's first attempt to drill was a dry hole, both Beach and DeepRock became concerned about the prospects of the partnership. DeepRock's leadership became concerned that it might not recover its investment in the partnership, which by then had increased to \$41 million. Under the original terms of the partnership agreement, DeepRock was entitled to only 80% of any distribution, so DeepRock would not be made whole until the partnership had distributed at least \$51.25 million. DeepRock sought to amend the agreement to provide that DeepRock would be entitled to recover its capital investment before Beach Capital and the general partner received any distribution. Beach, on behalf of Beach Capital, agreed to the amendment and executed an amended partnership agreement. Shortly after the amendment, the partnership began selling some of its assets. As a result, the partnership had more than \$41 million in cash on hand. In accordance with the amended agreement, the partnership distributed \$41 million to DeepRock, but made no distribution to the other partners.

The partnership had difficulty selling other properties, and eventually the relationship between the partners deteriorated. Beach proposed making a distribution to the partners, and DeepRock opposed Beach's proposal. Nevertheless, Beach distributed \$2.5 million to the limited partners, of which \$2 million went to DeepRock and \$500,000 went to Beach Capital. When DeepRock learned of the distribution, it immediately demanded that Beach return the \$500,000 distribution he made to Beach Capital, but no part of the \$2.5 million distribution was repaid to the partnership. The morning that Beach made the distribution, he emailed DeepRock, purporting to withdraw his consent to the amendment of the partnership agreement on the basis that DeepRock had never signed it. Beach initiated this action, naming himself, Beach Capital, the partnership, and the general partner as plaintiffs and DeepRock and Touradji as defendants. Beach claimed that DeepRock and Touradji had defrauded him by

misleading him into believing that DeepRock would fund drilling at its principal prospect only if Beach consented to the amendment to the partnership agreement. Beach thus claimed that he was entitled to 20% of the \$41 million that the partnership had distributed to DeepRock, i.e., \$8.2 million. He also alleged breach of fiduciary duty, breach of contract, and other claims. DeepRock and Touradji filed counterclaims on their own behalf and on behalf of the partnership, specifically seeking return to the partnership of Beach Capital's share of the \$2.5 million distribution, as well as all other damages. Shortly after the lawsuit was filed, DeepRock executed a written consent adopting the amendment to the partnership agreement. A few days later at DeepRock's instigation, the management committee of the partnership met and removed Beach from his position as CEO of the partnership, but Beach refused to step down and fired numerous executives and senior employees of the partnership. Beach continued to act as CEO and paid himself a salary through the end of trial.

After trial, the trial court entered a judgment based on jury findings as modified by the trial court. The judgment awarded Touradji and DeepRock damages, attorney's fees, costs, and pre-judgment and post-judgment interest. Of relevance to the appeal, the judgment included awards to DeepRock for 80% of each amount of the partnership's damages found by the jury for Beach's breach of his fiduciary duties, i.e., the \$500,000 that Beach Capital received in the \$2.5 million distribution, the \$300,000 that the jury awarded as damages for Beach's refusal to step down as CEO, and the \$100,000 that the jury found as damages for Beach's unauthorized bonuses, plus prejudgment interest. The judgment also gave Beach Capital an offset for the value of the partnership's assets, dissolved the partnership, ordered the court-appointed receiver to liquidate all of the partnership's assets and distribute the proceeds to DeepRock, and declared that the partnership agreement was validly amended.

On appeal, Beach first argued that there was insufficient evidence to support the trial court's award to DeepRock of \$500,000, which represented 20% of the \$2.5 million distribution that Beach made. Beach reasoned that Touradji and DeepRock had already received everything to which they were entitled (the \$41 million invested by DeepRock and 80% of the \$2.5 distribution) and the judgment unjustly enriched them by awarding an additional windfall and placing them in a better position than if the distribution had never been made. According to the Beach parties, the \$500,000 received by Beach Capital and the \$2 million received by DeepRock would have been distributed to the partners in the same proportions when the partnership wound up its operations. Notably, Beach and Beach Capital did not challenge the liability findings for breach of fiduciary duty and breach of the partnership agreement underlying this damages award. The court first explained that the jury award in question was for the economic loss to the partnership as a result of the distribution from the partnership to Beach Capital without DeepRock's consent. In other words, the jury was not asked to award Beach Capital's share of the distribution to DeepRock, nor did it directly determine the damages suffered by DeepRock or Touradji. The court assessed damages to the partnership in the amount and awarded 80% of the jury's award, or \$375,000, directly to DeepRock as the majority partner because the court simultaneously ordered dissolution of the partnership. The court rejected the Beach parties' argument that there was insufficient evidence in support of the award. Beach himself testified that he knew that his actions in making the challenged distribution "probably" violated the partnership agreement. Further, the evidence at trial showed that this distribution impaired the partnership's ability to meet its financial obligations and directly reduced the partnership's assets. Moreover, Beach testified that the partnership had essentially no value at the time of trial. A reasonable jury could have believed that the \$2.5 million distribution effectively rendered the partnership insolvent and that it sustained at least \$500,000 in damages as a result.

The Beach parties further argued that the judgment must be reversed because DeepRock and Touradji requested damages for Beach's breach of his fiduciary duties on behalf of the partnership, but the judgment awarded these damages directly to DeepRock and Touradji. The court pointed out that the judgment dissolved the partnership and ordered its receiver to distribute all remaining assets to DeepRock. The court cited Tex. Bus. Orgs. Code § 153.405, which provides that the trial court may direct which party shall receive recovered proceeds when a plaintiff prevails in a derivative action. Accordingly, the trial court awarded to DeepRock its share of the jury's \$500,000 award for damages to the partnership, or \$375,000, plus interest on that amount. The trial court awarded this amount solely to DeepRock, not to DeepRock and Touradji as asserted by the Beach parties. The award was thus entirely consistent with a payment of \$500,000 to the partnership and its simultaneous distribution to the partnership's partners. The trial court did not err in awarding this amount directly to DeepRock.

The court reviewed the evidence regarding the jury's verdict that Beach took unauthorized bonuses in violation of his fiduciary duties and that those bonuses caused more than \$100,000 in economic loss to the partnership and concluded that there was more than a scintilla of evidence to support the verdict. Finally, the court determined that the Beach parties did not timely object to jury submissions related to damages for Beach's refusal

to step down and regarding damages for breach of fiduciary duty by DeepRock and Touradji. Thus, any error related to those jury questions was waived.

***Murphree v. Godshall***, Civil Action No. H–13–0453, 2014 WL 4782936 (S.D. Tex. Sept. 24, 2014).

Murphree and Godshall entered into a Partnership Interest Assignment (PIA) pursuant to which Murphree assigned to Godshall a small portion of Murphree's interest in a Delaware limited partnership. The assignment was approved by the limited partnership's general partner, of which Murphree was an owner, and Godshall became a substitute limited partner. After Godshall began making claims that he was entitled to large sums of money from Murphree, Murphree filed this action seeking a declaratory judgment. Godshall filed counterclaims for fraud, breach of fiduciary duty, and other causes of action. Murphree sought summary judgment or dismissal of the counterclaims. Godshall alleged as follows with respect to his breach-of-fiduciary-duty claim:

Murphree sold and assigned a partnership interest to Godshall; such a transaction is between two partners. In such a transaction, especially in light of Murphree's position as majority GP interest holder, Murphree owed a fiduciary duty to Godshall. Murphree's misrepresentations, obfuscation, and likewise failure to present all the facts known to him demonstrate Murphree's breach of his fiduciary duty.

Godshall testified by affidavit regarding alleged misrepresentations and failures to disclose by Murphree. The court acknowledged that a fiduciary has a duty to disclose information under Texas law and cited Fifth Circuit case law that recognizes that fiduciary responsibilities flow between the parties once a partnership is established. However, the court stated that for a fiduciary relationship to exist incident to a business transaction such as the one at issue here “there must be a fiduciary relationship before, and apart from the agreement made the basis of the suit.” The court stated that Godshall did not cite any evidence that could establish that Godshall had a fiduciary relationship with Murphree that existed separate and apart from the agreement made the basis of this lawsuit (i.e., the PIA). Absent such evidence, a reasonable jury could not conclude that a fiduciary relationship between Godshall and Murphree existed before, and apart from, the agreement made the basis of the suit (i.e., the PIA). Additionally, the court concluded that Godshall failed to cite any evidence from which a reasonable jury could conclude that Murphree made any false representations or failed to disclose information he had a duty to disclose. Accordingly, Murphree was entitled to summary judgment on Godshall's breach of fiduciary duty counterclaim.

See also ***Jerry L. Starkey, TBDL, L.P. v. Graves***, 448 S.W.3d 88 (Tex. App.–Houston [14<sup>th</sup> Dist.] 2014, no pet.), summarized below under the heading “Interpretation of Partnership Agreement–Fiduciary Duties.”

See also ***In re Marguaux City Lights Partners Ltd.***, No. 12–35828–BJH, 2014 WL 6674922 (N.D. Tex. Nov. 24, 2014); ***Hodges v. Rajpal***, 459 S.W.3d 237 (Tex. App.–Dallas 2015, no pet. h.), summarized below under the heading “Standing; Direct versus Derivative Claims.”

See also ***Zaffirini v. Guerra***, No. 04-14-00436-CV, 2014 WL 6687236 (Tex. App.–San Antonio Nov. 26, 2014, no pet.) (mem. op.), summarized below under the heading “Injunctive Relief.”

#### **E. Partnership Property**

***Peterson v. Kroschel***, No. 01–13–00554–CV, 2015 WL 3485784 (Tex. App.–Houston [1<sup>st</sup> Dist.] June 2, 2015, no pet. h.) (mem. op.).

In this lawsuit arising out of a dispute between Peterson and Kroschel, who informally agreed to operate a business to remove sand from a pit for a drainage district, Peterson asked the court to declare that the business formed by the two men was a general partnership for a limited purpose and that the partnership had no equity in a tractor purchased for use in the business. The trial court declared that the parties formed a general partnership but made no other declaration. The court of appeals concluded that whether the tractor was partnership property was a disputed fact issue. The evidence showed that the contract with John Deere identified Peterson and Kroschel, individually, as the buyers, but several payments on the tractor were made from the partnership's bank account. The

court cited Tex. Bus. Orgs. Code § 152.102(b) (“Property is presumed to be partnership property if acquired with partnership property” regardless of whether it was acquired in the name of the partnership). Therefore, whether the partnership had an equity interest in the tractor was purely a factual dispute that the trial court could not have resolved with a declaratory judgment.

*JP Morgan Chase Bank, N.A. v. Professional Pharmacy II*, 2014 WL 7473779, \_\_ S.W.3d \_\_ (Tex. App.–Fort Worth 2014, no pet.).

A partnership sued its bank for negligence in setting up the partnership’s checking account as an account of a joint sole proprietorship. The account documentation identified individual partners as joint owners of the account, and the error subjected funds in the account to garnishment by a partner’s judgment creditor. The partnership recovered a judgment for damages against the bank, and the bank appealed. The court of appeals held that the bank owed a duty of care to the partnership in opening the account and responding to the writ of garnishment and that the breach of that duty damaged the partnership when an individual partner’s creditor reached funds of the partnership.

Pamela Ashu, Fidelis Bisong, and Tusmo Jama formed a retail pharmacy partnership, Professional Pharmacy II (“Pharmacy II”). The partners had previously formed Professional Pharmacy Plus (“Pharmacy Plus”), also a retail pharmacy partnership, which had a bank account at Washington Mutual Bank, predecessor of JP Morgan Chase Bank, N.A. There was no written partnership agreement for either Pharmacy Plus or Pharmacy II. The three partners filed an assumed name certificate for Pharmacy II, and Ashu obtained an Employer Identification Number (EIN) in the name of Pharmacy II as a partnership. Various applications and registrations were made in the name of Pharmacy II. When Ashu and Bisong opened a checking account for Pharmacy II at the bank, they furnished the bank a number of documents, including the assumed name certificate for Pharmacy II, Pharmacy II’s EIN, and a completed Form W–9 indicating Pharmacy II was a partnership. The bank’s branch manager testified that she asked Ashu and Bisong if they were married because the third person on the assumed name certificate was not present and she could not open the account as a partnership account without a written partnership agreement. The branch manager informed Ashu and Bisong that because they were married to each other, they could open a joint sole proprietorship account for Pharmacy II, and the branch manager designated Pharmacy II’s account as a joint sole proprietorship account in the paperwork that was prepared when Ashu and Bisong opened the account. Pharmacy II used the account as its operating account, and several years later a writ of garnishment was served on the bank seeking funds in accounts belonging to Bisong to be credited against a judgment against Bisong. Eventually, the bank withdrew \$116,000 from Pharmacy II’s account, and Pharmacy II sued the bank for breach of contract and negligence. The jury found that the bank was negligent and that its negligence caused injury to Pharmacy II. The trial court entered a judgment against the bank in favor of Pharmacy II, and the bank appealed.

On appeal, the bank first argued that Pharmacy II lacked standing to complain of the bank’s negligence in opening the account and responding to the writ of garnishment. Although Pharmacy II failed to obtain a jury finding that Pharmacy II and the bank agreed to open a partnership account, the failure did not preclude Pharmacy II from having a justiciable interest in the funds in the account. The court cited Sections 152.101 and 152.102 of the Business Organizations Code for the propositions that partnership property is not property of the partners and property acquired in the name of the partnership is partnership property. The evidence showed that the funds in Pharmacy II’s account belonged to Pharmacy II because the funds that were deposited in the account consisted of payments of various types to Pharmacy II and the account was used as Pharmacy II’s operating account. The court thus concluded that Pharmacy II had a justiciable interest in the funds paid out of the account and had standing to complain of the bank’s negligence in opening and paying funds out of the account.

The court next rejected the bank’s arguments that Pharmacy II failed to prove it was entitled to recover in the capacity in which it sued or, alternatively, was judicially estopped to claim it was a partnership. The court held that the bank failed to preserve its capacity complaint because the bank failed to file a proposed instruction on the partnership factors to preserve its complaint that Pharmacy II failed to obtain findings that Pharmacy II was a partnership. The bank argued that Pharmacy II was judicially estopped to claim it was a partnership based on positions taken by the partners in other lawsuits, but the court of appeals concluded that the bank did not point to any sworn, inconsistent statements by Pharmacy II in prior proceedings, and that any positions taken by Ashu and Jama that might be attributed to Pharmacy II appeared to be no more than inadvertent omissions or inconsistencies. Further, Pharmacy II did not prevail in these prior lawsuits. Thus, the doctrine of judicial estoppel did not apply.

The court also concluded that the bank failed to conclusively establish that Pharmacy II's negligence claim was barred by res judicata or collateral estoppel. In connection with its res judicata argument, the bank suggested that Pharmacy II was in privity with Bisong in the garnishment action because Bisong was a partner in Pharmacy II. In response to this argument, the court pointed out that a partnership is an entity distinct from its partners (Tex. Bus. Orgs. Code § 152.056), and the bank did not argue or point to any evidence that Pharmacy II controlled the garnishment action, that Bisong represented Pharmacy II's interests, or that Pharmacy II was Bisong's successor in interest. In addition, the negligence claim did not arise until the account was frozen and the funds withdrawn, which occurred after the negligence action was filed. Collateral estoppel was not established because the facts related to the negligence claim were not fully and fairly litigated in the action nor were the bank and Pharmacy II cast as adversaries in the action.

In response to the bank's argument that it owed no legal duty to Pharmacy II, the court concluded that there was a sufficient legal relationship between the parties to give rise to a duty. Pharmacy II was a customer of and had a relationship with the bank because Ashu and Bisong went to the bank to set up a partnership account for Pharmacy II similar to Pharmacy Plus's account. (Each partner is an agent of the partnership for the purpose of its business under Section 152.301 of the Business Organizations Code.) Ashu and Bisong informed the bank that they intended to open a partnership account and furnished documents showing the partnership's existence. This relationship was sufficient to give rise to a legal duty. Further, the bank was in a better position to guard against the injury that occurred since it could have reasonably anticipated that setting up an account incorrectly could result in a wrongful garnishment. The bank also had a duty to disclose any defense to the writ of garnishment of which it was aware, and it did not allege that Bisong did not own the funds even though partnership property is not the property of the partners (Tex. Bus. Orgs. Code § 152.101). The court emphasized that it was "not creating a general duty between a bank and a non-account holder," but concluded that the bank owed a duty to Pharmacy II "under the unique facts of this case."

The court rejected various other challenges to Pharmacy II's tort claim, including a challenge to the sufficiency of the evidence to support a finding that the bank breached its duty to Pharmacy II. The bank argued that the branch manager followed the bank's policies in opening the account, but the court stated that the bank's internal policies did not determine the standard of care. The branch manager was aware that Pharmacy II was a partnership and that Ashu and Bisong wanted to open a partnership account, but she nevertheless opened the account as a joint sole proprietorship account. In responding to the writ of garnishment, the bank stated that the account was owned in the name of Pharmacy II, but the bank failed to raise this defense and released funds that belonged to the partnership to the judgment creditor of Bisong. The evidence was also sufficient to support proximate cause because incorrectly setting up the account as a joint sole proprietorship account was a substantial factor in Pharmacy II's injury and the injury was a reasonably foreseeable result.

***In re Cavu/Rock Properties Project I, LLC***, 516 B.R. 414 (Bankr. W.D. Tex. 2014).

The debtor in this bankruptcy sought a declaration that a creditor's mechanic's lien was invalid on the basis that the creditor was actually a partner with the debtor in the development of the property on which the lien was filed. The court held that the creditor was not a partner with the debtor under Texas law, and the property was not partnership property, but the lien was invalid on other grounds.

Cavu/Rock Properties Project I, LLC ("Cavu Rock") owned a residential housing development in California (the "Property"), and Gold Star Construction, Inc. ("Gold Star") entered into a Development Agreement with Cavu Rock under which Cavu Rock would provide equity and debt financing to fund the project and Gold Star would act as the general contractor to develop the lots, construct homes, and market and sell to buyers. A choice of law clause dictated that Texas law governed the agreement. Gold Star recorded a mechanic's lien on the property in California when Cavu Rock became delinquent in paying Gold Star's invoices for work on the Property. Cavu Rock filed for Chapter 11 Bankruptcy in the Western District of Texas and filed this adversary proceeding asking the court to declare Gold Star's lien void and disallow its claim.

According to Cavu Rock, Gold Star's lien was invalid because Gold Star was a partner in the development of the Property pursuant to the Texas Business Organizations Code and was thus ineligible to hold a lien on the Property. The court found Cavu Rock's argument regarding Gold Star's status as a partner to be unavailing. The court stated that reasonable minds could differ as to whether Gold Star and Cavu Rock formed a partnership for the development of the Property, and the court found that they did not. The court stated that if it did determine Gold Star to be Cavu Rock's partner, the court would not invalidate Gold Star's lien on that basis. Cavu Rock argued that

partners may not assert a mechanic's lien against property that is the subject of their partnership. Cavu Rock cited a 1980 case from the Georgia Court of Appeals. The case was not binding authority on the court, and the court did not agree with Cavu Rock's reading of this case. The Georgia Court of Appeals' holding was premised on the fact that a party cannot hold a lien on its own property and that a partner thus cannot hold a mechanic's lien on partnership property. The court was not aware of any case that addressed property that is “the subject of the partnership.” Assuming a partnership existed between Gold Star and Cavu Rock, the Property could be “the subject of” that partnership but was not partnership property. The Development Agreement provided that Cavu Rock was the owner of the Property. If Gold Star was Cavu Rock's partner, this would not impair its ability to place a mechanic's lien on property that belonged to Cavu Rock rather than the partnership. Although Gold Star was not precluded from obtaining a valid lien on the Property, the court went on to determine that Gold Star's lien was invalid because Gold Star failed to comply with the recording requirements of California law. Gold Star's claim was valid, but it was an unsecured claim because Gold Star's lien was deficient under California law.

## **F. Interpretation and Enforcement of Partnership Agreement**

### **1. Fiduciary Duties**

*Jerry L. Starkey, TBDL, L.P. v. Graves*, 448 S.W.3d 88 (Tex. App.–Houston [14<sup>th</sup> Dist.] 2014, no pet.).

After the relationship between the companies and individuals involved in a limited partnership deteriorated, a limited partner sued the other partners and their owner for breach of the partnership agreement, statutory and common-law fraud, and breaches of the duties of loyalty and care. The plaintiff sought the same damages for every theory of liability, and the jury assessed the same damages against at least one of the defendants under each cause of action submitted. The court of appeals affirmed the award of actual damages under some of the jury findings but reversed the award of fees and costs because no evidence supported the statutory-fraud finding.

Glen Graves owned a three-story commercial building, which he intended to expand and renovate. After expending his own available funds and an additional \$500,000 from a bank loan, Graves needed more money to complete the work. He ultimately entered into multiple partnership agreements with Jerry Starkey or with two of Starkey's companies—PBW Development Corporation (the “General Partner”) and TBDL, L.P. (“TBDL”). The court referred to Starkey and the two companies collectively as the “Starkey parties.” The parties disputed the status and execution of three successive partnership agreements in 2006, 2007, and 2008, but the jury was not asked to resolve this factual dispute. Instead, Graves ultimately asked the trial court to submit breach-of-contract questions to the jury about each of the three agreements, and the jury found that all three were breached. The court thus referred to all three agreements as if each were executed by the parties.

Graves sued the Starkey parties, asserting claims against the General Partner and TBDL for breach of all three partnership agreements. In addition, Graves sought to hold all three of the Starkey parties liable under theories of statutory fraud, common-law fraud, conspiracy to commit fraud, breach of the duties of loyalty and care, and conspiracy to breach the duties of loyalty and care. Regarding the breach-of-contract claims, the jury found that Graves and Starkey “agreed in October 2006 to a written partnership agreement” that included among its terms that: (1) Graves “would be co-general partner with Jerry Starkey”; (2) Graves would receive \$1,500 per week as compensation; and (3) Starkey “would provide parking as part of his investment.” The jury found that the General Partner breached the 2006, 2007, and 2008 agreements; that TBDL breached the 2006 and 2007 agreements; and that TBDL's breach of the 2007 agreement was excused. In connection with the statutory-fraud claim, the jury was asked to determine whether Starkey, the General Partner, or TBDL falsely represented a past or existing material fact to Graves to induce him to enter the 2006 agreement. The jury found that Starkey and TBDL committed statutory fraud, but that Graves “ratified” TBDL's statutory fraud by entering into a new agreement or otherwise affirming the contract after becoming aware of the fraud. The jury also found that Starkey and the General Partner committed common-law fraud and breached the duties of loyalty and care to Graves. Finally, the jury found that Starkey and the General Partner conspired to commit statutory or common-law fraud and that they conspired to breach the duties of loyalty and care to Graves. As to each liability theory, Graves sought the same two measures of actual damages: “loss of compensation as general manager sustained in the past,” and “out of pocket losses sustained in the past.” The jury found that \$173,000 would fairly and reasonably compensate Graves for past loss of compensation and that \$437,000 would fairly and reasonably compensate him for past out-of-pocket losses. The jury answered questions allocating responsibility among the defendants it found liable for statutory and common-

law fraud and breach of the duties of loyalty and care. The trial court rendered judgment holding the General Partner and TBDL jointly and severally liable for actual damages of \$610,000 (the sum of \$173,000 for past loss of compensation and \$437,000 for past out-of-pocket losses).

On appeal, the Starkey parties asserted that Graves did not have standing to assert his causes of action because they involved claims owned and damages suffered by the partnership rather than by Graves individually. The jury charge showed that the claims Graves litigated were for: (a) breaches of contracts that he signed in his individual capacity; (b) statutory fraud in inducing him, in his individual capacity, to enter into one of the contracts; (c) common-law fraud against Graves; (d) conspiracy to commit that statutory or common-law fraud; (e) breach of the duties of loyalty and care to Graves; and (f) conspiracy to breach those duties of loyalty and care. Because these were all contractual, statutory, or common-law duties owed to Graves in his individual capacity, the court stated that breaches of such duties were not claims owned by the partnership. The Starkey parties also argued that the damages found by the jury were damages sustained by the partnership rather than by Graves individually. Graves did not dispute that if the Starkey parties misappropriated the partnership's funds or caused the partnership to lose profits or value, then those would be injuries suffered by the partnership rather than by Graves individually. However, Graves contended that he did not seek damages for diminution of the partnership's value and other such injuries to the partnership. Instead, the jury was asked to assess damages only for "loss of compensation as general manager sustained in the past" and "out of pocket losses sustained in the past." The court of appeals concluded that these damages compensated Graves for injuries sustained by Graves individually because the jury found that Graves and Starkey agreed in the 2006 partnership agreement that Graves would receive \$1,500 per week as compensation. The jury received no instruction on out-of-pocket losses, and this was thus a question of sufficiency of the evidence rather than standing.

The court rejected several challenges to the judgment as it related to the liability of TBDL and the General Partner for past loss-of-compensation damages of \$173,000 for breach of the 2006 partnership agreement.

Although the court of appeals concluded that the evidence did not support liability of Starkey based on statutory and common-law fraud, the court concluded that Graves could recover past loss-of-compensation damages from Starkey and the General Partner for breach of the duties of loyalty and care. The Starkey parties asserted that Graves could not recover for breach of the duties of loyalty and care because the 2008 agreement superseded the prior agreements and disclaimed these statutory duties. The court of appeals found it unnecessary to address whether the 2008 agreement superseded all prior agreements because the court concluded that the 2008 agreement limited but did not disclaim all statutory duties and liability. By way of a footnote, the court commented that the agreement could not disclaim the statutory duties entirely, citing Tex. Bus. Orgs. Code § 152.002(b)(2), (b)(3), which provide that neither the partnership agreement nor the partners may eliminate the duty of loyalty or the duty of care. The questions on breach of the duties of loyalty and care were accompanied by an instruction that Graves was required to show that the act or omission constituting the breach was performed or omitted fraudulently, or that it constituted gross negligence or willful misconduct as follows:

To prove [a defendant] failed to comply with its duty, Glen Graves must show that [the defendant's] actions or omissions were:

performed or omitted fraudulently

constituted gross negligence, or

constituted willful misconduct.

"Gross negligence" means an act or omission by [the defendant],

(a) Which when viewed objectively from the standpoint of [the defendant] at the time of its occurrence involve[d] an extreme degree of risk, considering the probability and magnitude of the potential harm to others; and

(b) Of which [the defendant] ha[d] actual, subjective awareness of the risk involved, but nevertheless proceed[ed] with conscious indifference to the rights, safety, or welfare of others.

You are instructed that under the Partnership Agreement, the General Partner, when permitted to make a decision in its discretion, shall be entitled to consider such interests and factors as it desires and may consider its own interests. Further, the General Partner may take any action or make any decision pursuant to the authority granted it in the Partnership Agreement so long as such action or decision was not performed or omitted with the intent to defraud or deliberately cause injury to the Limited Partners.

You are further instructed that neither the General Partner, its Affiliates, nor any owner, manager, officer, director, partner, employee or agent of the General Partner or its Affiliates, shall be liable, responsible or accountable in damages or otherwise to the Partnership or any Partner for any action taken or failure to act (even if such action constituted the negligence of a person) on behalf of the Partnership within the scope of the authority conferred on the person described in this Agreement or by law unless such act or omission was performed or omitted fraudulently or constituted gross negligence or willful misconduct.

The jury impliedly found that the acts or omissions that breached the duties of loyalty and care were performed or omitted fraudulently, or that they constituted gross negligence or willful misconduct. The Starkey parties did not challenge these implied findings, which supported the imposition of liability.

The Starkey parties additionally contended that Graves was not entitled to recover against Starkey for breach of the duties of loyalty and care because there was no jury finding that Starkey owed Graves duties of loyalty and care in the first place; however, the Starkey parties did not object in the trial court that the question concerning Starkey's liability was required to be predicated on a factual finding that he owed Graves any such duties. Thus, if such a finding was necessary, it was deemed found.

The court concluded that Starkey could be held jointly and severally liable with the General Partner for damages Graves sustained as a result of their breach of the duties of loyalty and care. The jury found that Starkey was responsible for causing or contributing to cause 60% of Graves's damages, and the General Partner was responsible for the remaining 40%. As with all of the other damage questions, the jury found that as a result of this conduct, Graves sustained damages of \$173,000 in past loss of compensation and \$437,000 in past out-of-pocket losses. The jury found that only Starkey and the General Partner were part of a conspiracy to breach the duties of loyalty and care. Starkey argued that he could not be held jointly and severally liable with the General Partner based on the conspiracy finding because the General Partner could not conspire with its only agent. He additionally contended that imposing joint liability based on the conspiracy finding would impermissibly circumvent the requirements for proving alter-ego liability. The court found it unnecessary to address these arguments because the court upheld the finding that Starkey and the General Partner were liable for breach of the duties and loyalty and care, and the Starkey parties did not challenge the jury's finding allocating 60% of the responsibility for this claim to Starkey. Thus, Starkey could be held jointly and severally liable with the General Partner for these damages even in the absence of a conspiracy finding based on Tex. Civ. Prac. & Rem. Code § 33.013(b) (providing that a defendant who is more than 50% responsible for the damages associated with a particular cause of action is jointly and severally liable for those damages).

The court of appeals concluded that there was legally insufficient evidence that Graves sustained out-of-pocket losses as result of breach of contract but sufficient evidence that he suffered such damages as a result of the breach of the statutory duties of loyalty and care. Graves contended that he contributed the building and received no payments, profits, or distributions, from the partnership; however, with the exception of the obligation to pay him the compensation agreed upon for his work as the general manager, there was no evidence that he was required to be paid any payments, profits, or distributions in the past under the terms of any of the partnership agreements. In the 2008 amended partnership agreement, Graves agreed that he would receive a 30% share of "distributable cash" in exchange for his contribution of the building to the partnership if and when such a distribution was made, but there was no evidence in the record that a distribution was made or was required to have been made. He also would receive a 30% share of the proceeds distributed upon the winding up and termination of the partnership's business, but that event had not occurred by the time of trial. As of the time of trial, Graves still retained his 30% share of the partnership. Graves also argued that the evidence showed that his initial capital contribution—and thus, the balance in his capital account going forward—was hundreds of thousands of dollars less than it should be. The



capital-account balances affected the amount each partner would be entitled to receive upon the winding up and termination of the partnership, an event that had not yet occurred. Thus, the reduction in Graves's capital account on the partnership's books did not cause Graves a past financial loss. In sum, Graves did not sustain a past out-of-pocket loss as a result of a breach of contract, because he received what he bargained for. But there was evidence that Graves sustained an out-of-pocket loss in the past as a result of the breach of the duties of loyalty and care because he lost part of what he *did* receive in exchange for contributing the building: his partnership interest. In 2008, Starkey made a “cash call” in which he told Graves that the partnership needed additional contributions of more than \$300,000. According to Graves, Starkey demanded that Graves provide all of these funds. Graves testified that because he would not agree to contribute the money, Starkey demanded that he sign the 2008 amended partnership agreement and threatened that if Graves did not sign it, then Starkey would have him thrown in jail. The effect of the 2008 agreement signed by Graves was that TBDL and the General Partner agreed to contribute an additional \$300,000 to the partnership and their interest in the partnership was increased by a total of 19%, while Graves's interest was reduced by 19%. In effect, the General Partner and TBDL purchased an additional 19% partnership interest for \$300,000. This was evidence from which a reasonable jury could conclude that when Graves signed the 2008 contract and lost a 19% share of the partnership, he suffered an out-of-pocket loss. The Starkey parties argued that Graves sought only to recover for reduction in the value of his partnership interest, but the court said that they ignored the reduction in the size of his partnership interest and thus did not contend that loss of part of Graves's partnership interest was not an out-of-pocket loss.

See also *In re Whittington*, 530 B.R. 360 (Bankr. W.D. Tex. 2014), summarized above under the heading “Fiduciary Duties of Partners and Affiliates.”

## 2. Financial Rights

*DPRS 15<sup>th</sup> Street, Inc. v. Texas Skyline, Ltd.*, No. 03-11-00101-CV, 2014 WL 4058796 (Tex. App.—Austin Aug. 13, 2014, no pet.) (mem. op.).

The former general partner of a limited partnership appealed a judgment for damages and attorney’s fees in a suit against it for breach of the partnership agreement. The court of appeals held that there was sufficient evidence to support the trial court’s findings that the general partner breached the partnership agreement by paying fees and making loans to the general partner or its affiliates and by making distributions that did not comply with the partnership agreement. The court also held that the award of attorney’s fees was supported by the statutory provisions on derivative suits and provisions of the partnership agreement.

Pecos & 15<sup>th</sup>, Ltd. (“Pecos”) was a limited partnership formed to construct a building to be leased to the State of Texas and ultimately sold. The general partner was DPRS 15<sup>th</sup> Street, Inc. (“DPRS”), which was solely controlled by Cliff Woerner, who was also a limited partner. DPRS owned a .01% interest, and Woerner owned a 49.99% interest. Texas Skyline, Ltd. (“Texas Skyline”) owned a 40% interest, and another individual, Reinking, owned the remaining 10% interest. Disputes arose over payments and distribution made by DPRS, and eventually Texas Skyline removed DPRS as general partner and named Skyline Interests, LLC (“Skyline”) as general partner. Woerner rejected Texas Skyline’s “unilateral decision” removing the general partner and refused to turn over the partnership books. Skyline and Pecos filed suit against DPRS and Woerner asserting various claims including breach of the partnership agreement. In a bench trial, the trial court concluded that DPRS and Woerner breached the partnership agreement by making unauthorized payments and loans to Woerner and distributing profits to Woerner and Reinking before making required distributions to Texas Skyline.

On appeal, DPRS and Woerner contended that the trial court erred in concluding that they breached the partnership agreement by paying Woerner general contractor's fees and overhead. The trial court concluded that DPRS and Woerner breached: (1) section 2.6 of the partnership agreement, which prohibited any partner from receiving any “interest, salary, or drawing ... for services rendered on behalf of the Partnership or otherwise in his capacity as a Partner, except as otherwise authorized in ... this Agreement”; (2) section 5.3(a)(vii), which prohibited any partner, without the consent of Texas Skyline, from entering into “any contract, agreement, ... or other arrangement for the furnishing to or by the Partnership of ... services ... with any party or entity related to or affiliated with the General Partner or with respect to any entity which the General Partner has any direct or indirect ownership or control unless ... authorized by section 5.6 ...”; and (3) section 5.6(a), which provided that “[e]xcept as otherwise provided in this Section 5.6, no Partner shall receive any salary, fee, or draw for services rendered to

or on behalf of the Partnership.” Woerner argued that the contractor fees and overhead need not be authorized under section 5.3 or section 5.6 because they were not payments to a partner for services to the partnership but were legitimate expenses of the partnership authorized by section 5.1 and paid to Woerner Interests, a nonpartner. However, the trial court made findings of fact that Woerner transferred more than \$817,000 in funds from Pecos's account to his personal and Woerner Interests accounts for his own personal use. The trial court also found that the other partners did not authorize or consent to a contract with Woerner Interests or to contractor's fees or overhead and that Woerner did not disclose the contract or transfers for contractor's fees and overhead. Because there was evidence supporting these findings and Woerner did not challenge the findings, they were binding on the court of appeals. Woerner testified that, as general partner of Pecos, he entered into an “oral contract” with Woerner Interests, his sole proprietorship, to act as general contractor and that he executed a written agreement and backdated it. The other limited partners testified that Woerner did not disclose the contract and that they did not authorize the contract or the fee and overhead payments to Woerner. Thus, the trial court’s findings supported its conclusions that Woerner breached the partnership agreement by orally contracting with and purporting to pay himself fees for services and overhead without the consent or knowledge of Texas Skyline.

Woerner also argued that the trial court erred in holding that he breached the partnership agreement by loaning himself money from Pecos funds. The trial court concluded that Woerner breached a provision of the partnership agreement that prohibited the general partner from lending Pecos funds to the general partner or any limited partner unless it was loaned under the same rates and payment terms that would be required of an independent third party or Texas Skyline consented to a loan on other terms. Woerner contended that the loan he made to himself was on the same terms and conditions as those under which he would have loaned money to any other party. However, the evidence supported the trial court’s finding that Woerner did not disclose the loan or any terms or produce any contract or loan documents between himself and Pecos and that the other partners did not authorize or consent to the loan. The only evidence of any terms of the loan was Woerner's testimony that he orally agreed with himself as general partner to pay the loan back at 8.5%, and Woerner admitted that if he had lent Pecos funds to a third party, he would have entered into a written loan agreement. The court of appeals thus held that the trial court did not err in concluding that Woerner breached the partnership agreement by orally agreeing to lend himself Pecos funds without stated terms that would have been required of a third party and without the consent of Texas Skyline.

Woerner next contended that the trial court erred in holding that he breached the partnership agreement by distributing profits to himself and Reinking. The trial court concluded that Woerner breached section 1.8(n) of the partnership agreement by failing to pay Texas Skyline its required monthly investment return of \$5,126 from January through September 2007 and section 4.1 by making distributions to himself and to Reinking before Texas Skyline received its unpaid investment return and unreturned investment capital. Section 1.8(n) defined “Investment Return” with respect to Texas Skyline as \$5,126 per month beginning in January 2007 and continuing until the sale of the property. Section 4.1 prohibited distributions to Woerner and Reinking until Texas Skyline received all accrued “Unpaid Investment Return” and “Unreturned Investment Capital.” The court of appeals pointed out evidence that supported the trial court’s finding that Texas Skyline did not receive all of its monthly investment return, and there was uncontradicted evidence that Texas Skyline did not receive any of its \$665,000 capital investment. The evidence also established that Woerner paid distributions to himself and Reinking before Texas Skyline received its unpaid investment return and unreturned investment capital. Woerner argued that Texas Skyline ratified the distributions, but the court of appeals held that Woerner waived that argument and that ratification was inapplicable under the facts of this case even if Woerner did not waive the argument. One reason the court of appeals rejected the ratification argument was the fact that the partnership agreement contained a non-waiver clause providing that the failure to insist on strict performance of any obligation or to exercise any right under the agreement did not constitute a waiver of any breach or duty. The court acknowledged that non-waiver clauses may themselves be waived but stated that they are generally considered valid and enforceable. Woerner did not contend that Texas Skyline expressly waived the non-waiver clause but cited Texas Skyline's acceptance of distributions after it knew of the distributions to Woerner and Reinking. The evidence showed that Texas Skyline took steps to assert its rights under the agreement within 10 days of learning of the distributions to Woerner and Reinking. Texas Skyline did so by reserving its right to replace DPRS as general partner and later doing so, pointing out that the loan and distributions violated the partnership agreement, attempting to remove records from Woerner's control, and ultimately filing suit. Thus, Texas Skyline did not “unequivocally manifest” an intent to no longer assert its rights under the non-waiver clause.

Finally, Woerner argued that there was no basis for the trial court's award of attorney's fees to Pecos and Texas Skyline. The trial court entered conclusions of law that Pecos was entitled to attorney's fees as the prevailing party in a breach of contract claim under Section 38.001 of the Civil Practices and Remedies Code and that Texas Skyline was entitled to attorney's fees as a derivative claimant under Sections 153.401 and 153.405 of the Business Organizations Code. Section 153.401 provides that a limited partner may bring an action on behalf of the limited partnership if "(1) all general partners with authority to bring the action have refused to bring the action; or (2) an effort to cause those general partners to bring the action is not likely to succeed," and Section 153.405 provides for the recovery of attorney's fees in a successful derivative action. Woerner argued that Pecos was not entitled to recover attorney's fees because it did not pay the attorney's fees, which were paid by Texas Skyline. Woerner also argued that Skyline Interests caused the partnership to sue Woerner after Skyline Interests became the general partner, and because the general partner did bring an action, Texas Skyline had no right to bring a derivative action. However, the attorney for Texas Skyline and Pecos averred by affidavit that he had been retained by Texas Skyline on behalf of Pecos and that all the parties had agreed that Pecos would reimburse Texas Skyline for the fees. The partnership agreement required Pecos to indemnify anyone who incurred any liability or expense by acting as a representative of the partnership. Further, the evidence showed that Texas Skyline executed a written consent removing DPRS as general partner and naming Skyline Interests in its stead but that Woerner refused to recognize the action or to turn over the books. DPRS, as general partner, did not institute the suit and as potential defendant was not likely to do so if asked. Texas Skyline then instituted the proceeding as a limited partner in Pecos, and Texas Skyline paid the attorney's fees on behalf of Pecos after the trial court issued a temporary injunction prohibiting the parties from using partnership funds during the pendency of the trial. There was also evidence that Pecos did not have sufficient funds to pay the fees after the withdrawals of funds made by Woerner. Thus, the trial court did not err in concluding that Pecos and Texas Skyline were entitled to recover attorney's fees.

*In re American Housing Foundation*, 520 B.R. 208 (Bankr. N.D. Tex. 2014); *In re American Housing Foundation*, Case No. 09-20232-RLJ, Adversary No. 11-02133-RLJ, 2015 WL 1543585 (Bankr. N.D. Tex. Mar. 21, 2015).

In these opinions, the court analyzed whether limited partners' investments in certain Texas limited partnerships were debt or equity. The debtor, which was the corporate general partner or the parent of the general partner of the partnerships, guaranteed the limited partner's investments. Applying factors considered under Texas law to distinguish between debt and equity, the court concluded that the limited partners' capital contributions were equity investments. Because the claims on the guaranties arose from the purchase of an equity security, the court concluded that they were subject to mandatory subordination under Section 510(b).

See also *Jerry L. Starkey, TBDL, L.P. v. Graves*, 448 S.W.3d 88 (Tex. App.–Houston [14<sup>th</sup> Dist.] 2014, no pet.), summarized above under the heading "Interpretation and Enforcement of Partnership Agreement–Fiduciary Duties."

See also *Beach Capital Partnership, L.P. v. DeepRock Venture Partners, LP*, 442 S.W.3d 609 (Tex. App.–Houston [1<sup>st</sup> Dist.] 2014, no pet.), summarized above under the heading "Fiduciary Duties of Partners and Affiliates."

### **3. Admission of Limited Partner**

*Plano AMI, L.P. v. Cruz*, No. 05–12–01480–CV , 2015 WL 128592 (Tex. App.–Dallas Jan. 9, 2015, no pet. h.).

The court of appeals held that the plaintiff failed to prove as a matter of law that he was a limited partner in a medical imaging center, and the trial court's instructions to the jury that he was a limited partner thus required reversal of the judgment.

Cruz, Ghani, and Taba created Ghani Medical Investments, Inc. ("GMI") and opened a medical imaging center, Plano AMI, L.P., a limited partnership ("Plano AMI"). GMI's sole asset was its interest in Plano AMI. The parties disputed the ownership structure of this entity. Ghani and Taba asserted that 60% of Plano AMI was owned by the corporate general partner, GMI, while physician investors owned the remaining 40% interest as limited

partners. Cruz, Ghani, and Taba, in turn, each held one-third of the GMI stock. According to Ghani, Cruz (a neurologist) and Taba (an orthopedic surgeon) preferred this structure because they did not want referring physician investors to know that they owned such large shares in the company. In contrast, Cruz claimed he, Ghani, and Taba each owned a 24% interest in Plano AMI as limited partners; GMI owned 1% as the corporate general partner; and physician investors owned the remainder. Under either scenario, Cruz, Ghani, and Taba owned equal interests in Plano AMI, directly or indirectly. Cruz argued that the partnership agreement established he was a limited partner as a matter of law and that Ghani and Taba were barred from denying Cruz was a limited partner by the doctrine of tax estoppel or quasi-estoppel. The trial court granted Cruz's partial summary judgment that Cruz was a limited partner, and Ghani and Taba argued on appeal that the trial court erred in doing so.

The court of appeals first held that the limited partnership agreement did not establish as a matter of law that Cruz was a limited partner. Cruz relied on the signature page of the agreement, where Ghani signed as president of GMI under the heading "GENERAL PARTNER" and Cruz, Ghani, and Taba each individually signed under the heading "LIMITED PARTNERS." Cruz argued his signature established as a matter of law his status as a limited partner; however, Exhibit A of the agreement only listed Ghani as a limited partner, and the court thus found that the agreement was ambiguous. The court rejected Cruz's arguments that the incomplete exhibit should be completed based on the signatures of Taba and Cruz and that the partnership agreement gave the general partner broad authority to forego the use of the exhibits.

The court of appeals next held that Ghani and Taba were not estopped from denying Cruz was a limited partner. Cruz asserted that Ghani and Taba were barred from denying he was a limited partner by the doctrine of tax estoppel or quasi-estoppel. Cruz relied on tax returns for several years showing that Cruz, Ghani, and Taba were limited partners in Plano AMI and GMI owned only a 1% general partner interest. But Ghani and Taba presented evidence that the tax returns for Plano AMI and GMI had been amended to reflect that Ghani, Taba, and Cruz were shareholders of GMI, the general partner of Plano AMI, and had 0% interest as limited partners. Nothing in the record indicated that the IRS rejected the amended returns, and Cruz did not present evidence to establish that Ghani and Taba benefitted in any way from being characterized as "limited partners" for tax purposes. The court stated that it need not decide the ownership structure of Plano AMI, who the limited partners were, or the percentages assigned to their interest. The court only had to decide whether Cruz established as a matter of law that he was one of the limited partners. Based on the summary judgment evidence, the court concluded he did not.

#### 4. Attorney's Fees

*Walnut Retail Center General Partner, LC v. LBL, Ltd.*, No. 04-13-00878-CV, 2014 WL 5463898 (Tex. App.–San Antonio Oct. 20, 2014, no pet.) (mem. op.).

The court interpreted a provision of a limited partnership providing for recovery of attorney's fees and concluded that the trial court did not err in concluding that neither the plaintiff limited partner nor the defendant general partner prevailed, and neither were entitled to recover attorney's fees.

Walnut Retail Center, Ltd. was a partnership that owned a shopping center in New Braunfels, Texas. LBL, Ltd. ("LBL"), a limited partner, sued Walnut Retail Center General Partner, LC ("Walnut GP"), the general partner, seeking to remove Walnut GP as general partner and to have the trial court appoint a temporary receiver. LBL also requested attorney's fees. Walnut GP filed a counterclaim against LBL, alleging LBL breached the partnership agreement, requesting a declaratory judgment, and seeking attorney's fees. At the close of evidence, Walnut GP moved for a directed verdict on LBL's claims against it, which the trial court denied. LBL also moved for a directed verdict on Walnut GP's counterclaim for a declaratory judgment and for breach of contract, but the trial court deferred ruling on the motion. The jury replied "No" to the question of whether Walnut GP committed willful neglect of duty in its management of Walnut Retail Center, Ltd. The only remaining question was for the jury to determine a reasonable fee for the necessary services of Walnut GP's attorney. Walnut GP moved for entry of judgment on the award of attorney's fees, and LBL objected on several grounds. The trial court's final judgment ordered that (1) LBL take nothing on its claims against Walnut GP, (2) Walnut GP take nothing on its claims against LBL; and (3) each party bear its own costs and attorney's fees. On appeal, Walnut GP asserted that it was entitled to recover its attorney's fees as the "prevailing party" at trial because it obtained a complete defense to LBL's causes of action. Walnut GP also asserted that the trial court erred by ruling that it did not prevail on its own claims against LBL because no jury questions on those claims were submitted and its claims were thus withdrawn and waived.

Walnut GP asserted that the trial court erred in failing to enforce the partnership agreement, which, in Walnut GP's opinion, mandated an award of fees to it as the prevailing party. Walnut GP also argued that the jury's award of attorney's fees was limited only to its successful defense against LBL's willful neglect claim, and that it was thus entitled to fees under the partnership agreement. The partnership agreement provided as follows:

Should the Partnership or any Partner(s) institute legal proceedings against any other Partner or the Partnership to interpret or enforce any provision, right or remedy under the Agreement, *the Court shall, in its discretion, include all or part of the prevailing party's or parties' attorney's fees as a recoverable cost against the losing party or parties.* To so recover, it is not necessary that the prevailing party prevail in each and every of its claims. Rather the amount of the award or attorney's fees shall, *in the Court's discretion, reflect the degree to which the prevailing party or parties have prevailed in some of their claims.* [Emphasis added.]

The court of appeals interpreted the agreement's use of the phrase “the Court shall” as unambiguously requiring the trial court to award attorney's fees to the prevailing party, but the amount of the attorney's fees was left to the court's discretion. Because the parties' agreement granted the trial court the discretion “to determine the degree to which the prevailing party or parties have prevailed in some of their claims,” the court reviewed the trial court's determination that neither party in this case prevailed for an abuse of discretion. The jury answered “no”—in favor of Walnut GP—to the only question on liability, which asked “Did Walnut Retail Center General Partner, LC commit willful neglect of duty in its management of the Walnut Retail Center Limited Partnership?” However, the court of appeals stated that it was the judgment rather than the verdict that must be considered in determining whether attorney's fees are proper. LBL did not prevail on its willful neglect claim against Walnut GP. Although Walnut GP later withdrew its claims against LBL, it did not obtain its requested declaratory judgment, nor did it obtain findings under Civil Practice and Remedies Code Chapters 9 or 10. The trial court rendered a take-nothing judgment against all parties. On this record, the court of appeals could not conclude the trial court abused its discretion in determining that neither party prevailed.

See also *DPRS 15<sup>th</sup> Street, Inc. v. Texas Skyline, Ltd.*, No. 03-11-00101-CV, 2014 WL 4058796 (Tex. App.—Austin Aug. 13, 2014, no pet.) (mem. op.), summarized above under the heading “Interpretation and Enforcement of Partnership Agreement—Financial Rights.”

#### **G. Withdrawal of Partner**

*Peterson v. Kroschel*, No. 01-13-00554-CV, 2015 WL 3485784 (Tex. App.—Houston [1<sup>st</sup> Dist.] June 2, 2015, no pet. h.) (mem. op.).

In this lawsuit arising out of a dispute between Peterson and Kroschel, who informally agreed to operate a business to remove sand from a pit for a drainage district, Peterson asked the court to declare that the business formed by the two men was a general partnership for a limited purpose and that the partnership terminated with the withdrawal of Kroschel. The trial court declared that the parties formed a general partnership but made no other declaration. The court of appeals stated that when there is no written partnership agreement, a person may withdraw from the partnership by giving notice of his “express will to withdraw” to the partnership, citing Tex. Bus. Orgs. Code § 152.501(a), (b)(1). In this case, Peterson testified that Kroschel “got off the tractor and said he needed to go talk to a lawyer” and that Peterson had not seen Kroschel since on another project. The court stated that this evidence did not conclusively establish that Kroschel withdrew from the partnership (i.e., that Kroschel gave unequivocal notice of his intent to withdraw to Peterson). Kroschel testified that he never withdrew from the business and that he was pushed out of the partnership by Peterson at some unspecified time. Thus, whether Kroschel withdrew from the partnership was a disputed fact issue.

#### **H. Standing; Direct Versus Derivative Claims**

*Hodges v. Rajpal*, 459 S.W.3d 237 (Tex. App.—Dallas 2015, no pet. h.).

The court of appeals held that limited partners in a limited partnership lacked standing to assert claims for breach of contract and breach of fiduciary duty against an individual who was a fellow limited partner and the

president and sole shareholder of the corporate general partner of the partnership. The court concluded that the claims belonged to the limited partnership, and the limited partners thus lacked standing to assert them.

Two limited partners of Greenville Travelers, L.P. (“Greenville Travelers”) sued Rajpal, who was a limited partner and the sole shareholder and president of the corporate general partner of Greenville Travelers. The plaintiffs argued that Rajpal owed contractual duties to them as a fellow limited partner and breached various provisions of the partnership agreement by withdrawing and using funds in violation of the agreement, failing to repay them their initial loans/investments, failing to distribute their share of the profits associated with the partnership’s property, and failing to provide financial reporting or accounting required by the agreement. With regard to their breach-of-fiduciary-duty claims, the plaintiffs alleged Rajpal was the person in control of Greenville Travelers and stood in a fiduciary capacity as to the limited partners. The jury heard evidence that Rajpal used funds of Greenville Travelers to make a loan to himself and pay for various personal expenses although the partnership agreement prohibited loans from the partnership to the general partner or any person. The jury found that Rajpal breached the partnership agreement and breached his fiduciary duty to the plaintiffs, but the court of appeals agreed with the trial court that the plaintiffs lacked standing to assert their claims.

In support of their argument that they had standing to sue on their claims, the plaintiffs relied on Section 152.210 of the Business Organizations Code, which provides that partners are liable to other *partners* for breach of a duty or breach of the partnership agreement that causes harm to the other partners. The court pointed out that Section 152.211 provides that a *partnership* may maintain an action against a partner for breach of the partnership agreement or for violation of a duty that causes harm to the partnership. The court relied on Texas case law in which claims by a limited partner based on misappropriation of partnership funds were held to belong to the partnership because the harm alleged was to the limited partnership rather than the limited partner. A limited partner does not have standing to sue for injuries to the partnership that merely diminish the value of the partner’s interest. The plaintiffs argued that Rajpal breached the limited partnership agreement by failing to repay their initial “loans/investments” and by failing to distribute their share of profits from operation and sale of the Greenville Travelers property, but the court found that this situation was governed by prior case law in which the court held that a right of recovery belonged to the general partnership “even though the economic impact of the alleged wrongdoing may bring about reduced earnings, salary or bonus.” With respect to the claims for breach of fiduciary duty, the court stated that they all related to alleged misuse or mismanagement of funds of Greenville Travelers with the effect of diminishing the assets and value of the limited partnership generally; therefore, the alleged harm was to Greenville Travelers, not the plaintiffs individually. The plaintiffs did not have a separate, individual right of action for injuries to the partnership, even if the injuries diminished the value of their ownership interest in the entity. Thus, only Greenville Travelers had standing to sue to recover the allegedly misused or mismanaged funds.

*In re Marguaux City Lights Partners Ltd.*, No. 12–35828–BJH, 2014 WL 6674922 (N.D. Tex. Nov. 24, 2014).

In the context of objections by two limited partners to a motion to approve a proposed settlement agreement of claims asserted in a lawsuit in state court against the general partner and related parties, the court analyzed whether the claims proposed to be released were derivative claims, and thus property of the estate of the limited partnership debtor that could only be pursued or released by the plan agent, or whether the claims belonged to the plaintiffs. The court concluded that claims for breach of contract, breach of fiduciary duty, fraud, fraudulent inducement to agree to a withdrawal and substitution of the general partner, and negligent misrepresentation were derivative, but a claim for breach of the partnership agreement and breach of fiduciary duty based on the failure to provide tax information to the limited partners as well as a fraudulent inducement claim to enter into the partnership agreement were direct claims belonging to the plaintiffs.

The plaintiffs’ breach of contract claim centered on allegations that the general partner and related parties breached the limited partnership agreement by failing to: (1) provide the plaintiffs with information regarding the partnership’s business affairs, (2) properly notice and hold regular meetings to make certain decisions, (3) disclose any relationships between the defendants and a secured lender, (4) timely provide tax returns and tax information to the plaintiffs, and (6) follow certain provisions for cash calls, assignments, and the disposition of partnership assets. The plaintiffs only vaguely described the damages resulting from these alleged breaches in their complaint. At the hearing held on the objections to the proposed settlement agreement, the court asked counsel for the objecting limited partners to articulate the direct injury suffered by her clients, i.e., damages not resulting from an alleged diminution in the partnership’s value. With the sole exception of theoretical damages related to tax liability,

she was not able to do so; therefore, based on the facial allegations in the petition, the court found that the plaintiffs' alleged damages were derived from direct damages to the partnership, making the claim property of the estate. The one exception to this finding was any damages arising from the defendants' alleged failure to timely provide tax returns and tax information to the plaintiffs. At the hearing, counsel for the objecting limited partners argued that the plaintiffs were harmed because the defendants failed to timely provide tax returns and tax-related information to the plaintiffs so that they could timely file their own returns. Further, the general partner allegedly moved property between the partnership and another entity, so the plaintiffs' respective tax returns, as filed, might not accurately depict what happened during the tax year. Because of this, the plaintiffs might have outstanding tax issues leading to additional tax liability, harm allegedly unique to the limited partners and separate and apart from any harm to the partnership. Thus, the court found that a claim for breach of the partnership agreement based upon the defendants' alleged failure to timely provide tax returns and tax-related information is a direct claim that may be pursued by the plaintiffs.

The plaintiff's claim for breach of fiduciary duty revolved around allegations of self-dealing with respect to the partnership's assets and business, hiding and/or misappropriating the partnership's assets, usurpation of the partnership's business opportunities, improperly competing and/or dealing with the partnership, and failing to provide information to the plaintiffs. As with the breach of contract claim, the petition contained no allegations that the plaintiffs were directly harmed as a result of the defendants' alleged acts. Again, when asked by the court at the hearing, the objecting limited partner's counsel was unable to articulate any injury to her clients separate and apart from injury to the partnership, except for the theoretical tax liability discussed above. Thus, with the exception of the claim as it related to the failure to provide information to the plaintiffs, the claim for breach of fiduciary duty was a derivative claim that belonged to the estate and could only be pursued or released by the plan agent.

The alleged misrepresentations and omissions that formed the basis of the plaintiff's claims for fraud, fraud by nondisclosure, and statutory fraud included representations and/or omissions about the planned development of the partnership's property, details of the amounts and nature of investments in the partnership, use of the partnership's assets, planned distribution of proceeds from the partnership, assignments with others not approved by the partners, and eventually the "outright heist of all" of the partnership's property. The court stated that the plaintiff's fraud allegations appeared to mirror the claims for breach of contract and breach of fiduciary duty that the court had found were derivative in nature. The petition failed to allege any damages to the plaintiffs that arose separate and apart from the diminution in the value of their limited partnership interests in the partnership. Thus, these fraud claims were derivative claims that could only be pursued or released by the plan agent.

The objecting limited partners argued that they had direct claims for fraudulent inducement regarding their (1) initial entry into the limited partnership agreement, and (2) their entry into a transaction in which a previous general partner withdrew and the defendant general partner was substituted as general partner (the "General Partner Withdrawal"). The court analyzed these claims and concluded that the plaintiff's claim that they were fraudulently induced to enter into the limited partnership agreement was a direct claim. The defendants argued that any claim accruing to all limited partners, such as a loss of their initial investments, was a derivative claim belonging to the partnership, but the court said that the partnership itself did not suffer any direct damage from the alleged inducement that resulted in the plaintiffs' entry into the limited partnership agreement and the payment of their initial investments. The claim for fraudulent inducement to enter into the General Partner Withdrawal, however, was a derivative claim. According to the plaintiffs, once the defendant general partner gained control of the partnership, the defendants began to self-deal, usurp corporate opportunities, mismanage the partnership, attempt to improperly dispose of assets, and take various other improper actions. The nature of the plaintiffs' alleged injury appeared to derive solely from the diminution in value of their respective interests in the partnership. Thus, the fraudulent inducement claim, as it related to entry into the General Partner Withdrawal, was a derivative claim that could be released by the plan agent.

The court analyzed the plaintiffs' claim for negligent misrepresentation and concluded that the claim alleged harm to the partnership and that any harm to the plaintiffs arose derivatively due to the diminution in value of the limited partnership interests. Thus, this claim was property of the estate that could only be pursued or released by the plan agent.

Finally, the court determined that the plaintiffs' claims for civil conspiracy and exemplary damages were dependent on the underlying tort claims and were derivative claims that were property of the estate to the extent the claims discussed above were derivative claims. To the extent the court found the claims to be direct claims, the associated claims for civil conspiracy and exemplary damages were direct claims.

*Loudder v. Crop Quest Inc.*, No. 07–13–00185–CV, 2014 WL 3360240 (Tex. App.–Amarillo July 8, 2014, pet. denied) (mem. op.).

The Loudders and their partnership sued a company retained by the partnership to provide services in connection with the partnership’s farming operations. The claims included violations of the Texas Deceptive Trade Practices Act (DTPA). The trial court granted a no-evidence summary judgment motion filed by the defendant against the Loudders. The defendant alleged that the service contract that formed the basis of the plaintiffs’ complaint was between the defendant and the Loudders’ partnership, 2L Farms, and that there was thus no evidence that the plaintiffs, Brandon Lance Louder and Terri Louder, were consumers under the DTPA. According to the defendant, the consumer was 2L Farms since the contract was with that entity, not with the Louders individually. The court of appeals interpreted this argument as an effort to invoke the entity theory of partnerships recognized in Texas, citing *In re Allcat Claims Serv., L.L.P.*, 356 S.W.3d 455, 463–64 (Tex. 2011) and the Texas Revised Partnership Act and Texas Business Organizations Code. Given this argument, the Loudders were required to address whether being partners in the 2L Farms partnership qualified them as consumers under the DTPA even though they did not sign the contract individually. The Loudders did not address this issue; they simply argued that because the definition of “consumer” includes “individuals” and they were individuals, they were thus consumers. They did not address whether members of a partnership qualified as consumers *vis-a-vis* a transaction when the transaction is between the partnership (not the partners) and a third party, and they thus failed to demonstrate that the trial court could not have granted summary judgment against the Loudders on their DTPA claims.

See also *Jerry L. Starkey, TBDL, L.P. v. Graves*, 448 S.W.3d 88 (Tex. App.–Houston [14<sup>th</sup> Dist.] 2014, no pet.), summarized above under the heading “Interpretation and Enforcement of Partnership Agreement–Fiduciary Duties.”

See also *DPRS 15<sup>th</sup> Street, Inc. v. Texas Skyline, Ltd.*, No. 03-11-00101-CV, 2014 WL 4058796 (Tex. App.–Austin Aug. 13, 2014, no pet.) (mem. op.), summarized above under the heading “Interpretation and Enforcement of Partnership Agreement–Financial Rights.”

## **I. Injunctive Relief**

*Zaffirini v. Guerra*, No. 04-14-00436-CV, 2014 WL 6687236 (Tex. App.–San Antonio Nov. 26, 2014, no pet.) (mem. op.).

The beneficiary of trusts holding limited partner interests in several family limited partnerships sued other family members who, in their capacities as trustees, executors, and attorneys-in-fact, controlled the general partner of the limited partnerships. The plaintiff asserted claims for breach of fiduciary duty and sought and obtained temporary injunctive relief. The court of appeals rejected the plaintiff’s argument that she was not required to make a showing of irreparable injury to obtain injunctive relief in a breach of fiduciary duty case of this nature, and the court of appeals thus dissolved the injunction.

As part of their estate planning, sisters Josefina Alexander Gonzalez and Delfina E. Alexander transferred 1,000 acres of real property to a limited partnership and formed other limited partnerships to manage and develop the property. A limited liability company also was formed to act as the general partner of the limited partnerships. Josefina and Delfina also formed the Delfina & Josefina Alexander Family Trust, an irrevocable trust that owned 90% of the limited partnership interests in most of the limited partnerships. Guerra, Josefina's daughter, and Guerra's two children were the sole beneficiaries of the Family Trust. Delfina passed away, and her will left the residuary of her estate to the Rocio Gonzalez Guerra Exempt Trust of which Guerra was the sole beneficiary. Judith Zaffirini, David H. Arredondo, and Clarissa N. Chapa, were named as the co-executors of Delfina's estate and the co-trustees of the Exempt Trust. They also served as the attorneys-in-fact under a power of attorney executed by Josefina, who became unable to manage her business affairs. In these various capacities, Zaffirini, Arredondo, and Chapa controlled the management of the LLC that made the decisions for the limited partnerships. Guerra sued Zaffirini, Arredondo, and Chapa, individually and in their capacities as co-executors of Delfina's estate and co-trustees of the Exempt Trust, seeking their removal as co-executors and co-trustees and alleging numerous causes of action, including breach of fiduciary duty and fraud. Finally, Guerra sought and obtained a temporary injunction, which was the subject of this appeal. Guerra did not challenge the appellants’ assertion that she failed



to negate an adequate remedy at law since she could be adequately compensated in damages for the attorneys' fees spent in the appellants' defense. Guerra contended instead that she was not required to prove that she lacked an adequate remedy at law. The court distinguished the cases relied on by Guerra and noted that Guerra did not entrust the money in question to the appellants but rather Delfina and Josefina entrusted their money to the appellants in their capacities as attorneys-in-fact, co-executors, and co-trustees. In addition, the trial court made no finding that the various instruments pursuant to which the appellants administered the money did not authorize them to expend money in their defense of Guerra's lawsuit. Finally, there was no showing that the money used by the limited partnership and general partner to pay the attorney's fees would otherwise be distributed by the limited partnership as partnership distributions and eventually be provided to Guerra in the interim for support. Furthermore, the funds being expended on the attorney's fees would not "otherwise be available to pay a judgment" if Guerra obtained a judgment against the appellants. More importantly, however, the court disagreed that the requirement of irreparable injury was not applicable where the underlying claim alleges a breach of fiduciary duty. In the absence of Texas Supreme Court precedent establishing an exception to the inadequate legal remedy requirement for obtaining a temporary injunction under the circumstances of this case, the court declined to adopt any broad exception in cases involving a breach of fiduciary duty. Because Guerra failed to prove that damages would not adequately compensate her for any injuries she might prove at trial, the temporary injunction was improper.

## **J. Personal Jurisdiction**

*Fiduciary Network, LLC v. Buehler*, Civil Action No. 3:15-cv-0808, 2015 WL 2165953 (N.D. Tex. May 8, 2015).

The court held that the plaintiff had made at least a preliminary showing of "overlap" between a corporation and a limited partnership for purposes of pursuing the plaintiff's argument that the alter-ego doctrine permitted the contacts of the corporation to be imputed to the limited partnership for purposes of the exercise of personal jurisdiction.

The plaintiff sued a Pennsylvania limited partnership that provides investment and wealth management advice and a Pennsylvania CPA firm, and the defendants moved to dismiss for lack of personal jurisdiction. The court first determined that the plaintiff had made a preliminary showing regarding the nature and quality of the CPA firm's commercial activity sufficient to permit the plaintiff to conduct a Rule 30(b)(6) deposition on the CPA firm's contacts with Texas. The court then addressed the plaintiff's argument that it should be able to pursue discovery to support the exercise of personal jurisdiction over the limited partnership based on the imputation of the CPA firm's contacts under the alter ego doctrine. The court stated the test to overcome the presumption of "corporate separateness" under Texas law for personal jurisdiction purposes as follows: "'To 'fuse' the parent company and its subsidiary for jurisdictional purposes, the plaintiffs must prove the parent controls the internal business operations and affairs of the subsidiary.' [citation omitted] However, 'the degree of control the parent exercises must be greater than that normally associated with common ownership and directorship; the evidence must show that the two entities cease to be separate so that the corporate fiction should be disregarded to prevent fraud or injustice.'" The court listed the following relevant factors in this analysis: "'(1) the amount of stock owned by the parent of the subsidiary; (2) whether the entities have separate headquarters, directors, and officers; (3) whether corporate formalities are observed; (4) whether the entities maintain separate accounting systems; and (5) whether the parent exercises complete control over the subsidiary's general policies or daily activities.'" The plaintiff pointed to declarations submitted by the CPA firm's chairman and the limited partnership's managing director of the financial services group that showed the shareholders of the CPA firm established the limited partnership and that the partners and members of the limited partnership's subsidiaries are the same and include the CPA firm's chairman. The defendants argued that the plaintiff could not allege enough facts to support even an inference that the limited partnership would be subject to jurisdiction in Texas under an alter-ego theory. The defendants noted that the plaintiff sought to establish personal jurisdiction over the controlled company, rather than the controlling company, and the plaintiff provided no authority by which the alter-ego doctrine was applied to impute business presence in Texas of a controlling entity to a related, controlled entity that lacked Texas contacts, but the court noted in a footnote that the Texas Supreme Court has implicitly acknowledged that the contacts of a parent might be imputed to a subsidiary. Even if permissible, the defendants argued that the mere overlap between shareholders of the CPA firm and partners of the limited partnership did not show such a relationship between the entities. The CPA firm had no ownership interest in the limited partnership and was not its direct or indirect parent. The court

stated that the factor-based test for alter-ego jurisdiction is by its very nature a fact-intensive inquiry requiring the court to carefully weigh the various areas of overlap between the disputed entities. The court concluded that the plaintiff made a preliminary showing of overlap between the entities, and that there was at least a fact issue with respect to the actions of the CPA firm's chairman on the limited partnership's behalf. Accordingly, the court permitted the plaintiff to conduct a Rule 30(b)(6) deposition limited to these issues.

*Waller Marine, Inc. v. Magie*, 2015 WL 1456879, \_\_ S.W.3d \_\_ (Tex. App.–Houston [14<sup>th</sup> Dist.] 2015, no pet. h.).

The court held that the alleged formation of a partnership between nonresidents and residents of Texas did not support the exercise of personal jurisdiction over the nonresidents.

The plaintiff sued several parties for breach of contract, including a South Dakota LLC and its sole member, Scott Magie, an individual resident of Utah and Minnesota. Neither the LLC nor Magie maintained a regular place of business in Texas, and they filed special appearances. The plaintiff argued that the operative facts of the litigation would include proof of Magie's and the LLC's partnership with Texas resident defendants so that the plaintiff could obtain a judgment against Magie and the LLC as partners. Although the court agreed that a partnership with a Texas resident might give rise to relevant jurisdictional contacts, the existence of the partnership itself was not dispositive. The existence of a partnership bore upon the question of liability for the alleged breach of contract, not upon the question of jurisdiction. In addition, the court noted that the plaintiff had not yet sued the alleged partnership, nor had the plaintiff explained why it could proceed directly against other partners without suing the partnership. In a footnote, the court pointed out provisions of the Business Organizations Code addressing the enforcement of partnership liability against a partner. Thus, the court concluded that the alleged formation of a partnership with Texas residents would not support specific jurisdiction over Magie or the LLC.

*Aries International, LLC v. Isramco Negev 2 Limited Partnership*, Civil Action No. 4:13-cv-3745, 2014 WL 4924002 (S.D. Tex. Sept. 24, 2014).

The court held that the plaintiff did not sufficiently allege personal jurisdiction over a general partner of a limited partnership. The fact that the limited partnership was subject to the court's jurisdiction and that the general partner could be held liable on the contract that was the basis of the suit did not necessarily subject the general partner to personal jurisdiction.

An Israeli limited partnership (Isramco Negev 2 Limited Partnership or "Isramco Negev") entered into a Commission Agreement in Texas. The agreement was signed by Haim Tsuff, the Chairman and CEO of Isramco Negev. The plaintiff filed suit against Isramco Negev and its general partner (Isramco Oil & Gas, Ltd. or "IOG") to collect amounts allegedly owed under the agreement. IOG sought dismissal of the suit against it on the basis that the court lacked personal jurisdiction over it. IOG was also an Israeli limited partnership, and the court concluded that the plaintiff's allegations did not support either general or specific jurisdiction over IOG. With respect to specific jurisdiction, IOG argued that it was neither a party to nor a signatory of the commission agreement made the basis of the plaintiff's claims and that there was no legitimate basis for haling it from Israel to Texas for an alleged breach of the commission agreement when Isramco Negev, an actual party to the agreement, had appeared and did not challenge the court's authority to exert jurisdiction over it for the claims. The plaintiff did not dispute that IOG was a foreign limited partnership or that it did not conduct business in Texas. Rather, the plaintiff suggested that specific personal jurisdiction over IOG existed due to IOG's status as the general partner of Isramco Negev. Specifically, the plaintiff asserted that the actions and activities between the parties to the commission agreement, including meetings and negotiations, involved IOG, as Isramco Negev's general partner, by and through Haim Tsuff in Houston, Texas. The plaintiff further contended that the commission agreement by its terms bound IOG because the agreement referred to "affiliates" of Isramco Negev. The court stated that these allegations were insufficient to support the exercise of specific jurisdiction over IOG in this case. Though the parties' relationship with each other may be significant in assessing their ties to the forum, the minimum contacts requirement must still be met as to *each* defendant. The court stated that the plaintiff appeared to impermissibly blur the notions of liability and personal jurisdiction and that the plaintiff failed to direct the court to any authority supporting the position that a general partner may be subjected to personal jurisdiction in a forum based solely on its status as a general partner of a limited partnership. Further, the court stated that Haim Tsuff's signature on the commission agreement was sufficient to bind only the principal disclosed, Isramco Negev, despite the numerous positions and/or titles held by Haim Tsuff, in his capacity as an officer of the various entities. In sum, the court concluded that there

was no showing that IOG had any relationship with the plaintiff relative to the facts underlying the lawsuit that would cause IOG to anticipate being haled into a Texas court because IOG was not a party to or a signatory of the commission agreement entered into by and between the plaintiff and Isramco Negev.

*Nacho Remodeling Company, Inc. v. Calsherm Partners, L.P.*, No. 05–14–00048–CV, 2014 WL 3828219 (Tex. App.–Dallas Aug. 5, 2014 no pet.) (mem. op.).

The plaintiff sued a limited partnership and its limited partners for breach of contract. The trial court granted special appearances filed by the limited partners, and the plaintiff appealed. The court of appeals concluded the trial court did not err in granting the special appearances.

The plaintiff sued a limited partnership for failing to pay for repairs to an apartment complex in Sherman, Texas, owned by the limited partnership. After the plaintiff added the limited partners as defendants, each of the limited partners filed a special appearance. The trial court granted the special appearances, and the plaintiff appealed.

The court of appeals explained that once the limited partners filed their special appearances, the plaintiff did not provide controverting evidence and did not object to any of the evidence provided in support of the limited partners' special appearances. The plaintiff argued in its reply brief on appeal that it was not necessary to do so because the limited partners' act of deciding to form a limited partnership under Texas law for the sole purpose of deriving income from the operation of an apartment complex in Texas was all that was needed to give a Texas court jurisdiction over the limited partners for matters relating to the Texas limited partnership formed by them and the apartment complex owned and operated by that partnership. However, the court was bound to accept as true the affidavits and evidence in support of the limited partners' special appearances, and the uncontroverted evidence established that the limited partners were California residents and passive investors and had no purposeful contacts with Texas. The evidence showed that the limited partners were never involved in the partnership's daily operations, could not participate in the management or control of the partnership according to the terms of the partnership agreement, had no power to act or bind the partnership, and never purposefully engaged in business in Texas with the intent to invoke rights and privileges afforded to Texas residents. The basis for jurisdiction in this suit focused on the limited partners' passive investment in the partnership, and the limited partners' passive investments were not activities purposefully directed to Texas.

*Nautic Management VI, L.P. v. Cornerstone Healthcare Group Holding, Inc.*, No. 05-13-00859-CV, 2014 WL 2807980 (Tex. App.–Dallas June 18, 2014, pet. filed) (mem. op.).

A Delaware limited partnership that served as general partner or manager of other Delaware limited partnership investment funds appealed from the trial court's order denying the general partner's special appearance, and the court of appeals reversed the trial court's order and granted the special appearance, holding that the plaintiff did not present evidence of the general partner's contacts with Texas related to the acquisition of a hospital chain that was the basis of the plaintiff's suit and did not rebut the general partner's evidence that it did not have contacts with Texas related to the hospital acquisition.

Nautic Management VI, L.P. (NMVI), a Delaware limited partnership with its principal place of business in Rhode Island, was the general partner of two private equity funds and the manager of a third (the "Funds") that indirectly acquired through numerous subsidiaries a chain of hospitals in Texas. The plaintiff was interested in acquiring hospitals, and the plaintiff's executives identified as an opportunity for acquisition a chain of eight Texas hospitals operating under the Reliant name. Instead of presenting the opportunity to the plaintiff, the executives presented it to Nautic Partners, LLC, a private equity firm that services private equity funds including the Funds. Hilinski, a managing director of Nautic Partners and NMVI, performed due diligence and presented the investment opportunity to NMVI's investment committee, which authorized the Funds to make the investments. The Funds created numerous direct and indirect subsidiaries to acquire and operate the hospital chain. The plaintiff sued its executives, Hilinski, NMVI, the Funds and others for claims including breach of fiduciary duty and usurpation of corporate opportunity.

The plaintiff alleged that NMVI purposefully availed itself of the privilege of doing business in Texas and committed torts in Texas. The petition alleged that the Funds, "through [t]heir general partner [NMVI]," traveled to Texas to meet with the former executives about the Reliant acquisition, that NMVI "purposefully invested and acquired a business that is based in Texas," and that NMVI was actively involved in the management of Reliant, which has extensive operations in Texas. NMVI argued in its special appearance that the plaintiff's jurisdictional

allegations were the same as those with respect to the Funds, whose special appearances were granted. NMVI asserted and offered evidence to support that it had no contacts with Texas. It also asserted and offered evidence that it had no ownership interest in the Reliant subsidiaries. The plaintiff asserted that NMVI's special appearance was different from the Funds' special appearances because: (1) NMVI's fiduciary, Hilinski, traveled to Texas as part of the conspiracy to usurp the Reliant opportunity from the plaintiff and to aid and abet the executives' breaches of their fiduciary duties to the plaintiff; (2) NMVI's delegate, Nautic Partners, LLC conducted extensive due diligence in Texas in order to evaluate the Reliant opportunity and report its findings to NMVI; and (3) NMVI was the decision-maker and authorized the Funds' investment that ultimately acquired the assets of Reliant Hospital Partners, LLC, including all its Texas assets. NMVI claimed the court lacked personal jurisdiction over it, but the trial court denied the special appearance. NMVI appealed.

On appeal, NMVI argued that the trial court lacked personal jurisdiction because (1) the evidence showed that Hilinski and others acted as officers of Nautic Partners, LLC (the private equity firm) when they investigated the Reliant opportunity, (2) the contacts of Nautic Partners, LLC during the due diligence process could not be attributed to NMVI because the plaintiff did not prove Nautic Partners, LLC was an agent of NMVI, and (3) NMVI's involvement in the Reliant transaction was limited and occurred in Rhode Island, and ownership of a Texas subsidiary was insufficient to support personal jurisdiction in this case. The plaintiff argued on appeal that NMVI's role in the Reliant transaction was not limited and that the sale would never have occurred but for NMVI's approval. The plaintiff argued that NMVI received a substantial fee “for finding, investigating, and planning the acquisition” and that NMVI controlled the money, authorized the deal, issued capital calls, had exclusive and complete control of the Funds, created the wholly owned subsidiaries by signing the Reliant acquisition documents on behalf of the Funds, and automatically controlled the board of every Reliant entity through its relationship to the Funds. The plaintiff argued that there was evidence that Hilinski's contacts were on behalf of NMVI, not just Nautic Partners, LLC, and that NMVI's transaction fee “could only be for the due-diligence activities.” The plaintiff's brief stated that the plaintiff was not seeking to impute acts to NMVI, but was relying on NMVI's own acts to establish minimum contacts. In oral argument, the plaintiff stated that it was not trying to “pierce any veils.”

The court of appeals concluded that the plaintiff did not present evidence that NMVI had any contacts with Texas regarding due-diligence activities. NMVI contended that its evidence showed that Hilinski's contacts with Texas regarding the Reliant acquisition were made on behalf of Nautic Partners, LLC and all of NMVI's activities regarding the Reliant acquisition were after the due diligence had been conducted and were done in Rhode Island. The plaintiff argued that the fee NMVI received at the closing “could only be for due-diligence activities” because it was designated for services before the closing, but the closing documents referred to the fee as a “transaction fee,” and the plaintiff did not cite any evidence that the fee was for due-diligence activities conducted by NMVI.

NMVI also argued on appeal that the contacts of Nautic Partners, LLC with Texas could not be imputed to it because Nautic Partners, LLC was not its agent. The plaintiff argued that the contacts at issue were by NMVI, not an independent contractor, but argued in any event that purposeful availment occurs if a nonresident hires an independent contractor specifically to transact a deal in Texas. Assuming that is the law, which the court said it need not decide, the court stated that the plaintiff cited no evidence that NMVI hired Nautic Partners, LLC specifically to transact a deal in Texas.

NMVI also argued that its own involvement in the Reliant transaction was not sufficient to confer specific jurisdiction. It presented evidence that its investment committee's activities with respect to the Reliant transaction all occurred in Rhode Island and were limited to hearing a presentation about the opportunity, considering the investment, authorizing the investment, and issuing capital call notices to fund the transaction. The plaintiff argued that NMVI controlled the board members and remained a “key player” in the future of the Texas hospitals through its control of the Funds, but the plaintiff expressly stated it was not asserting jurisdiction under a piercing-the-veil theory. Thus, the court did not consider whether NMVI exercised such control over its direct and indirect subsidiaries such that they should be considered fused.

The court concluded that the plaintiff did not present evidence of NMVI's contacts with Texas related to the Reliant hospital acquisition and did not rebut NMVI's evidence that it did not have contacts with Texas related to the Reliant hospital acquisition. For the additional reasons articulated in its related opinion at 2014 WL 2538881 (see below) the court concluded that personal jurisdiction over NMVI was lacking.

***Cornerstone Healthcare Group Holding, Inc. v. Reliant Splitter, L.P.***, No. 05–11–01730–CV, 2014 WL 2538881 (Tex. App.–Dallas June 5, 2014, pet. filed).

The plaintiff in a suit against three Delaware limited partnership investment funds appealed the trial court’s order granting the special appearances of the partnerships. The partnerships formed subsidiaries to acquire a chain of hospitals in Texas, and the plaintiff argued that the acquisition and ownership of these entities established minimum contacts. The court of appeals held that the partnerships took no direct action in Texas and marketed no product in Texas and that the degree of control over the subsidiaries was no greater than that normally exercised. Thus, the trial court did not err in granting the special appearances.

The plaintiff was interested in acquiring hospitals, and the plaintiff’s executives identified as an opportunity for acquisition a chain of eight Texas hospitals operating under the Reliant name. Instead of presenting the opportunity to the plaintiff, the executives presented it to Nautic Partners, LLC, a private equity firm that services private equity funds including three Delaware limited partnership investment funds (the “Funds”). The investment opportunity was presented to the Funds, which created numerous direct and indirect subsidiaries to acquire and operate the Reliant hospital chain. The plaintiff sued various defendants including the Funds for usurpation of a corporate opportunity. The Funds filed a special appearance asserting that they were partnerships formed and existing under Delaware law with their principal place of business in Rhode Island. They argued that they did not engage in business in Texas, had no registered agent or office in Texas, had no certificate to do business in Texas, and had no offices, property, phone number, or bank account in Texas. The Funds argued that they were passive investors via subsidiaries of a holding company that owned the hospital chain. The trial court granted the special appearances, and the Funds appealed.

On appeal, the plaintiff relied on two cases. First, the plaintiff relied on *Schlobohm v. Schapiro*, in which the Texas Supreme Court held “that a nonresident who funds a Texas company, controls its board, and is actively involved in its affairs has established minimum contacts with the state.” The court of appeals interpreted the plaintiff as essentially arguing that the existence of the subsidiaries should be ignored and the Funds required to appear in a Texas court because they controlled the funding and the board of the subsidiaries and played a strategic and advisory role to the subsidiaries. The plaintiff also relied on the Texas Supreme Court’s opinion in *Spir Star AG v. Kimich*. In that case the court held “that a nonresident who intentionally targets the Texas market and gains substantial profits from doing so cannot avoid personal jurisdiction merely by conducting its Texas business through a subsidiary.” The court of appeals found neither *Schlobohm* nor *Spir Star* dispositive of this case. The court distinguished *Schlobohm* on the basis that the nonresident defendant in that case took an active role in a Texas business, investing nearly half a million dollars of his personal funds and repeatedly coming to Texas to take part in the business affairs. Among other things, the defendant in that case came to Dallas and obtained financing for the business, signed a promissory note in his individual capacity, personally guaranteed some of the business’s leases in Texas, and demanded that all shares in the corporation be transferred to him. *Spir Star* was a products liability case in which a German manufacturer established a Texas distributorship that used the trademarked “Spir Star” name and acted as Spir Star’s exclusive distributor in Texas and North America. In addition, Spir Star marketed its product through a distributor who agreed to serve as its sales agent in Texas. Here, according to the court of appeals, the Funds took no direct action in Texas and did not market any product in Texas. Rather they invested in the Reliant hospitals through subsidiaries. The record did not show that the Funds controlled the internal business operations and affairs of the subsidiaries at issue or that the degree of control exercised by the Funds was greater than that normally associated with common ownership and directorship such that the subsidiaries at issue were not “separate” from the Funds under the standard for jurisdictional veil piercing set forth in *BMC Software Belg., N.V. v. Marchand*, 83 S.W.3d 789, 793 (Tex.2002). The court thus concluded that the trial court did not err in granting the Funds’ special appearances.

#### **K. Limited Partner Class Certification in Breach-of-Fiduciary-Duty Case**

***In re ParkCentral Global, L.P.***, No. 3:09-cv-765-M, 2014 WL 4261950 (N.D. Tex. Aug. 25, 2014).

The court denied class certification to limited partners of a hedge fund organized as a Delaware limited partnership in a breach-of-fiduciary-duty case against employees of the general partner. The fact that joinder of individual members of the purported class was not impracticable militated against class certification. Additionally, the putative class did not meet the requirements of Rule 23(b)(1)(B) because the claims did not fit within one of the historical categories of appropriate cases for class certification and did not constitute a limited fund case. Finally,

the differences in the information and communications sent to and received by members of the putative class and differences in the risk tolerance and redemption rights of members of the putative class created individualized issues as to whether they received false or misleading representations or omissions, the extent to which they relied on any such misrepresentations or omissions, and what damages the individual limited partners suffered. These differences precluded class certification under the predominance requirement of Rule 23(b)(3).

In the course of the discussion of the differences that precluded class certification, the court addressed the issue of the limited partners' reliance on allegedly false or misleading representations. The plaintiffs maintained that they were entitled to a rebuttable presumption of reliance because hedge funds offer a closed universe of information to their investors, thus making a presumption of reliance logical. The plaintiffs conceded that the fraud-on-the-market theory's presumption of reliance could not apply in this because there was not an efficient market, public information, or a situation where the information affects the price in the same sense as in the case of a publicly traded company. The plaintiffs contended that they were nevertheless entitled to a presumption of reliance because they were asserting actionable nondisclosures, and the closed universe of information received from defendants thus warranted such a presumption. But in a case where breach of fiduciary duty is premised on omissions, Delaware has limited presumed reliance to cases where shareholder or partner action is requested and has explicitly rejected the notion of a rebuttable presumption of fraud-on-the-market-type claims. This case did not involve an allegation of statements made to partners with a request for partner action. Thus, the court concluded that the class members in this case would not be entitled to a presumption of reliance under Delaware law.

## **L. Receivership**

*Spiritas v. Davidoff*, 459 S.W.3d 224 (Tex. App.–Dallas 2015, no pet. h.).

In this interlocutory appeal of an order appointing a receiver over a partnership and another entity, the court of appeals concluded that none of the grounds for appointment of a receiver under the Business Organizations Code were present.

In litigation between Steven Spiritas, individually and as trustee of a trust (“Spiritas”), and Susan Davidoff, individually and as trustee of a trust (“Davidoff”), the trial court appointed a receiver over Spiritas Ranch Enterprises, LLP (the “Partnership”) and J. Spiritas Land & Cattle Company (the “Company”). Spiritas and Davidoff each owned 50% of the Partnership and the Company. The parties disputed whether the Company was a limited liability company or a corporation, but the distinction was not material for purposes of this opinion. In the litigation, the parties asserted multiple claims against each other arising out of disputes regarding the Partnership, and during the course of the litigation, Davidoff filed an emergency motion for a receiver alleging that the Partnership did not realize a profit from the cattle operations of the Company conducted on the Partnership's property, that Spiritas and Davidoff were deadlocked over the management of the Partnership, and that Spiritas refused to cooperate in a sale of the Partnership's property to a residential developer in order to maximize the value of the partnership. Eventually, the court appointed a receiver for the Partnership and the Company, and Spiritas appealed the appointment of the receiver.

On appeal, the court of appeals reviewed provisions of the Business Organizations Code (BOC) providing for the appointment of a receiver or similar person for a domestic entity. These provisions are: Section 11.401 (generally authorizing appointment of a receiver for a domestic entity as provided for under the BOC), Section 11.403 (appointment of a receiver for specific property of a domestic entity), Section 11.404 (appointment of a receiver to rehabilitate a domestic entity), Section 11.405 (appointment of a receiver to liquidate a domestic entity), Section 11.054 (appointment of a person to supervise the winding up of a domestic entity), Section 152.703 (appointment of a person to carry out the winding up of a partnership), and Section 101.551 (appointment of a person to carry out the winding up of an LLC). Spiritas contended the trial court abused its discretion by appointing a receiver to market and sell the assets of the Partnership and the Company because Davidoff did not prove, and the trial court did not find, any of the statutory requirements for the appointment of a receiver under the BOC. The record before the court of appeals did not show what authority the trial court relied upon in appointing the receiver in this case. Because the Partnership and the Company were “domestic entities,” a receiver could be appointed over the entities or their property or business “only as provided for and on the conditions set forth in” the BOC. Tex. Bus. Orgs. Code § 11.401.

Davidoff first contended that an event requiring winding up had occurred and that the trial court was thus authorized under Sections 152.702(a)(3), 101.551, and 11.054 to appoint a receiver to wind up the Partnership and

the Company. Each of those three sections provides for the appointment of “a person” in certain instances pertaining to the winding up of entities, but the court pointed out that none of those sections contains the word “receiver” or provides for the appointment of a “receiver.” Assuming without deciding that the record showed the occurrence of an “event requiring winding up,” the court did not agree with Davidoff that the appointment of a receiver was authorized by any of those three sections.

Second, Davidoff asserted that if no event requiring a winding up occurred, the requirements of Section 11.403 were met, and appointment of a rehabilitative receiver was proper pursuant to Section 11.404. Section 11.403 pertains to appointment of a receiver for “specific property,” and Section 11.404 pertains to appointment of a receiver to “rehabilitate” a domestic entity. The trial court stated in its order that it found it was in the best interest of the Partnership and the Company to have a receiver appointed in order to wind up the entities. Further, the trial court specifically empowered the receiver to take all steps necessary to market and sell the assets of the entities including the ranch property of the Partnership. Because the order in this case did not show appointment of a receiver for “specific property,” the court concluded Section 11.403 was inapplicable. The court construed Davidoff’s argument to assert that provision (B) of subdivision 11.404(a)(1) was applicable, i.e. “the governing persons of the entity are deadlocked in the management of the entity’s affairs, the owners or members of the entity are unable to break the deadlock, and irreparable injury to the entity is being suffered or is threatened because of the deadlock.” Even assuming that the parties were “deadlocked” in the management of the affairs of the entities, the court did not agree with Davidoff that her testimony regarding a letter of intent received by the Partnership to purchase its property demonstrated a threat of irreparable injury to the entities as a result of the purported deadlock. Spiritas asserted that Davidoff offered no evidence or argument at the hearing on the motion to appoint a receiver that the property was in danger of materially depreciating in value, or that any developer’s interest in the property would somehow disappear if marketing efforts were not immediately undertaken. The court agreed that there was no evidence before the trial court of a threatened irreparable injury at the time of the order in question. Therefore, the appointment of a receiver pursuant to Section 11.404 was not supported by the record.

Finally, the court addressed Section 11.405, which pertains to the appointment of a receiver to liquidate a domestic entity. Section 11.405 is applicable in five circumstances listed in subsection 11.405(a) if the requirements of subsection 11.405(b) are also satisfied. The record showed four of those circumstances were inapplicable. The one other circumstance is “on application of a creditor of the entity if it is established that irreparable damage will ensue to the unsecured creditors of the domestic entity as a class, generally, unless there is an immediate liquidation of the property of the domestic entity.” Tex. Bus. Orgs. Code. § 11.405(a)(4). Even assuming that the record showed that a trust controlled by Davidoff was a “creditor” of the Partnership, the statute also required evidence that “irreparable damage” would ensue in the absence of an immediate liquidation. The court had already concluded earlier in its opinion that the record did not show that the trial court had before it any evidence of a threatened “irreparable injury” at the time of the order in question. The parties did not address whether “irreparable damage” is distinguishable from “irreparable injury,” and the court found no authority to support any difference between the terms. Thus, the court concluded that the record did not show any evidence of “irreparable damage” that would ensue, and the appointment of a receiver pursuant to Section 11.405 was not supported by the evidence.

## **M. Bankruptcy**

*In re American Housing Foundation*, 785 F.3d 143 (5<sup>th</sup> Cir. 2015).

The Fifth Circuit Court of Appeals affirmed the subordination of a limited partner’s claim on a guaranty by the debtor corporate general partner of the limited partnership, and reversed and remanded for further proceedings on fraudulent transfer and preference claims against the limited partner.

American Housing Foundation (“AHF”), the debtor, was in the business of developing low-income housing projects. Among other arrangements, AHF created various single-purpose limited partnerships to fund these projects. Either AHF or one of its wholly owned subsidiaries served as the general partner for these limited partnerships. Private investors would buy into the limited partnerships and serve as limited partners, and AHF guaranteed repayment of those investments, often unconditionally, and sometimes with interest. Robert Templeton invested in limited partnerships formed under the auspices of AHF—ultimately investing over \$5 million. As described above, either AHF or a wholly owned AHF subsidiary served as the general partner (taking a 1% or less equity interest in the limited partnership), while Templeton served as a limited partner (taking, along with other

limited partners, most of the equity in the limited partnership). Templeton asserted claims against AHF based on the guaranties and based on various state law causes of action related to his investments. The bankruptcy court issued a judgment subordinating those claims. The court also voided, as preferential, transfers made to Templeton within 90 days of the bankruptcy filing. However, the bankruptcy court refused to void allegedly fraudulent transfers. The district court affirmed the bankruptcy court in full.

Although the trustee's theory for subordination of Templeton's claim was based on the premise that Templeton's investments were abusive tax shelters and that Templeton knew or should have known this, the court of appeals found it unnecessary to decide whether such conduct warrants subordination under bankruptcy law. The court affirmed the subordination of Templeton's claim based solely on Section 510(b) of the Bankruptcy Code, which provides:

For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

The court first concluded that Templeton's claims were claims for "damages." With respect to the "unliquidated claims"—i.e., those for fraud, breach of fiduciary duties, and money-had-and-received—Templeton clearly sought damages for injuries resulting from these torts. Whether Templeton's "liquidated claims" (seeking reimbursement under AHF's guaranties) also constituted claims for damages was a more difficult question. Although Templeton sued for the breach of the guaranties of his limited partnership interests (rather than suing directly for repayment of his equity investments), the court said that this was the kind of elevation of form over substance that Section 510(b) seeks to avoid—by subordinating claims that functionally seek to "recover a portion of claimants' equity investment[s]." Further, several circuits have adopted a broad reading of "damages" under Section 510(b). Templeton's claims on the guaranties were essentially breach-of-contract claims, and the court concluded that they were fairly characterized as claims for "damages."

The court stated that there was no doubt that the limited partnership interests Templeton purchased constituted "securities" within the meaning of Section 510(b) because the Bankruptcy Code expressly defines the term "security" to include the interest of a limited partner in a limited partnership. 11 U.S.C. § 101(49)(A)(xiii). The court also concluded that Templeton's claims arose from the purchase of those securities, which required that there be some "nexus or causal relationship" between the claim and the purchase. Such a nexus between Templeton's claims and his purchase of the limited partnership interests was evident from his appellate brief in which he made clear that his unliquidated tort claims for breach of fiduciary duty, fraud, and other causes of action stemmed directly from the limited partnership investments. With respect to the guaranty claims, the bankruptcy court specifically found that the guaranties were "intimately intertwined" with the limited partnership agreements, and that "the guaranties cannot be considered apart from the other transactions that arose in connection with the investments." These findings were not clearly erroneous and showed at least some nexus or relationship between Templeton's claims and his purchase of the limited partnership interests. Further, the fact that Templeton was effectively attempting to recoup his equity investments in the limited partnerships through his claims supported the application of Section 510(b).

The court next determined that the limited partnership interests were securities of an affiliate of AHF under Section 510(b). The Bankruptcy Code defines "affiliate," in relevant part, as a "person whose business is operated under a lease or operating agreement by a debtor, or person substantially all of whose property is operated under an operating agreement with the debtor." 11 U.S.C. § 101(2)(C). Each of the limited partnerships was a "person" that was "operated under a[n] ... operating agreement." The court stated that there was little doubt that a limited partnership agreement constitutes an "operating agreement," although the term "operating agreement" is undefined in the Bankruptcy Code. The limited partnership agreements defined the business and purposes of each partnership, making clear that each partnership acted through its general partner to accomplish those purposes. The court also concluded that the limited partnerships were "operated under ... operating agreement[s] by a debtor," because AHF or a wholly owned subsidiary of AHF was the general partner of each partnership. Although AHF was not a direct party to the partnership agreements where a subsidiary was the general partner, it was undisputed that it exercised



complete control over the partnerships. The court noted some cases that were “in tension” with its analysis, but the court saw “no reason why the existence of a shell conduit between a debtor and an entity—which in no way inhibits the debtor's ability to control and operate that entity—should preclude a finding of affiliate status.”

In sum, because each of Templeton's claims was a claim for damages arising from the purchase of securities of AHF's affiliates, the court held that Section 510(b) mandated the subordination of those claims.

The court next analyzed Templeton's challenge to the bankruptcy court's decision to avoid certain payments as preferential transfers to Templeton. In the course of this analysis, the court concluded that AHF was the de facto owner of a bank account of one of the limited partnerships for purposes of characterizing the account as property of the estate. However, the court reversed the preferential transfer judgment for further proceedings as to the “ordinary course of business” defense raised by Templeton with respect to the interest payments to him at issue.

The court reversed and remanded the bankruptcy court's refusal to set aside certain payments to Templeton as fraudulent transfers based on Templeton's defense that he gave value and was in good faith. The court concluded that the court did not apply the correct test for good faith and made no factual findings on value; therefore, the court remanded for further proceedings on this claim.

See also *In re Whittington*, 530 B.R. 360 (Bankr. W.D. Tex. 2014), summarized above under the heading “Fiduciary Duties of Partners and Affiliates.”

#### **N. Fraudulent Transfer**

*Securities and Exchange Commission v. Helms*, No. A-13-CV-1036 ML, 2015 WL 1040443 (W.D. Tex. Mar. 10, 2015).

The court held that a security interest obtained by a limited partner in an oil and gas limited partnership to secure the limited partner's investment was a fraudulent transfer under the Texas Uniform Fraudulent Transfer Act (TUFTA). The court concluded that, at the time of the limited partner's investment, the limited partnership's business was operated as a Ponzi scheme, which created a presumption that the grant of the security interest was made with fraudulent intent. The limited partner argued that it was entitled to protection as a good faith purchaser for value, but the court stated that the limited partner could not meet the objective test of good faith under TUFTA. The limited partner's lack of due diligence and unreasonable reliance on a side letter with the general partner (which conflicted with some of the terms of the limited partnership agreement) did not support a showing of objective good faith. Further, the preferential treatment of the limited partner in the side letter under which the security interest was granted by the general partner on behalf of the limited partnership was a breach of the general partner's fiduciary duty, and the side letter was void. Thus, the limited partner's security interest did not attach under the Texas Uniform Commercial Code.

The court analyzed the enforceability of a security interest obtained by Clovis Capital Ventures, LLC (“Clovis”) when it invested in Vendetta Royalty Partners, Ltd., an oil and gas limited partnership. The limited partnership was organized and marketed as a standard limited partnership that would hold and distribute royalty interests from approximately 2,000 oil and gas wells located principally in Texas. Clovis ultimately invested \$2.885 million in the limited partnership in exchange for its limited partnership interest. In order to induce Clovis to make its investment, the general partner executed a side letter agreement in which it agreed to transfer to Clovis certain properties from the limited partnership's portfolio upon certain “trigger events.” Pursuant to the side letter, the limited partnership executed a collateral assignment and other documents effectuating the arrangement. Eventually, the Securities and Exchange Commission filed a securities fraud action against the principals involved in the limited partnership and other entities and obtained appointment of a receiver. In this opinion, the court addressed the receiver's motion to reject the secured claim of Clovis and sell the royalty interests Clovis claimed as collateral free and clear of all liens.

The court detailed the testimony of a forensic accountant who testified that the limited partnership operated as a Ponzi scheme. The accountant testified that even if a portion of the limited partnership's business was a legitimate business operation with legitimate royalty interests, the distributions to limited partners were still largely paid out of investor funds. The qualifications and credibility of the accountant were not seriously questioned, and no expert offered an opposing opinion. The court found the accountant credible and persuasive and concluded that the receiver showed by a preponderance of the evidence that the limited partnership had become a Ponzi scheme

prior to Clovis's investment. In the Fifth Circuit, the existence of a Ponzi scheme creates the presumption that a transfer is made with actual intent to defraud the transferor's creditors. Once the receiver proved the existence of a Ponzi scheme, the burden shifted to Clovis to establish any applicable defense under TUFTA. Clovis claimed that the transfer of the security interest was not voidable because Clovis took in good faith for reasonably equivalent value. Tex. Bus. & Com. Code § 24.009.

Clovis argued that it paid reasonably equivalent value to obtain its security interest in the collateral, but capital contributions and other investments alone are not generally sufficient to convey reasonably equivalent value. Clovis admitted its capital contribution was structured as an investment rather than a loan, and the court pointed out that other investors who received the same sharing percentage did not receive a security interest. However, Clovis argued that its investment was more valuable because it came at the end of the enterprise and was thus more meaningful. The court stated that Clovis's \$2.885 million could plausibly be characterized as an exchange of reasonably equivalent value for the collateral, but the court found it unnecessary to decide this issue because Clovis's defense failed based on the "objective good faith" prong.

Although the court did not question that representatives of Clovis believed in good faith that they were investing in a legitimate business operation and were obtaining a valid security interest, the court detailed evidence that showed the Clovis representatives did not meet an objective good faith standard, which is required under TUFTA. The court addressed what the representatives of Clovis should have known, and found that the evidence did not support objective good faith. The court described the due diligence process engaged in by Clovis as being lacking, and the court addressed a number of contentions of Clovis relating to its argument that it acted reasonably.

Clovis argued that it reasonably believed that the expected rate of return was feasible, but the court stated that the unreasonably high and speedy rate of return expected on the investment was a red flag. The court characterized the expected rate of return as "inherently unreasonable" and concluded that Clovis should have known the expected profit was "too good to be true."

Clovis argued that it acted in good faith and as a prudent investor by collateralizing its investment as memorialized in the side letter, but the court pointed out that a comparison of the side letter and the partnership agreement revealed that the side letter violated the partnership agreement in numerous respects. First, the side letter stated that it shall be deemed an amendment to the partnership agreement, but the partnership agreement required the written consent of a majority in interest of the limited partners as well as the general partner. Second, the side letter would automatically transfer the collateral, which was partnership property, to Clovis upon a "trigger event," but the partnership agreement provided that the property of the partnership was owned by the partnership as an entity and not by any individual partner. Third, the side letter provided that the quarterly royalty payments distributed to Clovis were in lieu of interest on the capital contribution, but the partnership agreement provided that no interest would accrue on capital contributions. Fourth, the side letter stated that the sale of the collateral was expected to provide more than adequate funds to return the full capital contribution of Clovis, but the partnership agreement stated that a limited partner was not entitled to a return of its capital contribution except by unanimous agreement of the partners or upon dissolution. Clovis argued that the partnership agreement gave the general partner full authority to incur obligations and encumber assets as well as stating that persons may rely on the authority of the general partner with no duty to inquire into the general partner's authority. The court acknowledged these provisions but responded by stating that a general partner in a limited partnership owes a fiduciary duty to the partnership and the limited partners under Tex. Bus. Orgs. Code §§ 153.152(a), 152.204(a). The court described the duty of a general partner under Texas law as follows: 'a general partner 'acting in complete control stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of a trust.'" The court stated that construing the partnership agreement as Clovis argued would give the general partner carte blanche to ignore various provisions and to encumber assets with little consequence, and the provisions protecting the limited partners would be completely overridden. The court declared that the side letter was void as a result of its provisions violating and attempting to amend the partnership agreement. The court agreed that some of the provisions of the partnership agreement may be contradictory, but the court stated that a comparison of the side letter and the partnership agreement would lead a reasonable transferee to believe the attempted transfer breached the general partner's fiduciary duty to the limited partners by placing Clovis ahead of other limited partners. At a minimum, the court thought that a comparison would lead a reasonable transferee to inquire into the nature of the transfer. Clovis did not conduct meaningful due diligence, and no representative explained the obvious inconsistencies between the side letter and the partnership agreement. The side letter thus did not support Clovis's argument that it acted in objective good faith.

Clovis contended that it did not know whether any other investors collateralized their investment with a security interest, and therefore had no reason to believe the transfer was fraudulent. It was undisputed, however, that Clovis was provided with the partnership private placement memorandum and the partnership agreement at the time Clovis subscribed to the offering, and these documents described the terms under which limited partners invested. The court stated that a reasonable, prudent investor should know preferential treatment of one Class A limited partner over other limited partners in the same class was at least unusual, and would have thoroughly investigated the issue. None of the Class A limited partners sought full repayment of their principal investment through collateralization, and Clovis should have known the transfer of the security interest was potentially a fraud upon the other investors.

Clovis next contended that it in good faith attempted to structure its security interest in a way that would not affect the partnership's credit facility with its bank, but the court stated that Clovis should have more thoroughly investigated the partnership's credit facility, which might have prohibited the partnership from transferring or otherwise encumbering the royalty interests that Clovis obtained as collateral.

Clovis did not address the fact that two of its representatives received promotional expenses far in excess of what was allowed by the PPM. The court concluded that this fact also weighed against proof of objective good faith.

In sum, considering the evidence in its totality, the court concluded that Clovis should have known the collateralization of its investment was a fraudulent transfer. Clovis therefore could not show that it acted with objective good faith, and its affirmative defense under TUFTA failed. Accordingly, the receiver showed by a preponderance of the evidence that the transfer was fraudulent, and the transfer of the security interest to Clovis was voidable. Additionally, because the court found that the side letter was void and unenforceable, Clovis' purported security interest did not attach under the Texas Uniform Commercial Code. The court noted that, as a former Class A limited partner, Clovis might be entitled to receive a share of the proceeds from the sale of the receivership assets, including a portion of the proceeds from the sale of the royalty interests that Clovis attempted to obtain as collateral. However, that question was left for a later date.

See also *In re American Housing Foundation*, 785 F.3d 143 (5<sup>th</sup> Cir. 2015), summarized above under the heading "Fraudulent Transfer."

### **III. Recent Texas Cases Involving Limited Liability Companies**

#### **A. Nature of Limited Liability Company**

*Hoffman v. L & M Arts*, Civil Action No. 3:10-CV-0953-D, 2015 WL 1000838 (N.D. Tex. Mar. 6, 2015).

The court concluded that Section 38.001 of the Civil Practice and Remedies Code, which permits a prevailing party in a breach-of-contract case to recover attorney's fees from "an individual or corporation," does not permit recovery of attorney's fees from a limited liability company.

The plaintiff prevailed on a breach-of-contract claim against the defendant, and the plaintiff sought to recover attorney's fees under Section 38.001 of the Texas Civil Practice and Remedies Code. Section 38.001 provides that, if a claim is for any of eight specific categories, including a valid claim for "an oral or written contract," "[a] person may recover reasonable attorney's fees from an individual or corporation, in addition to the amount of a valid claim and costs." The defendant in this case was a limited liability company. The Supreme Court of Texas has not yet addressed whether Section 38.001 permits the recovery of attorney's fees from an LLC; therefore, the court was required to predict how the Texas Supreme Court would resolve the issue if presented with the same case. 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 § 311.005(2). But Section 38.001 provides that attorney's fees may be recovered from "an individual or corporation" rather than a "person." Neither the Civil Practice and Remedies Code nor the Code Construction Act defines the term "individual" or "corporation." Thus, the court was faced with the question of whether an LLC falls within the scope of "an individual or corporation." The court stated that an LLC clearly was not an "individual" within the ordinary meaning of the term, and Texas courts of appeals and federal courts

interpreting Section 38.001 have held that the term “individual” refers to humans rather than partnerships, governmental subdivisions, or other legal entities. The plaintiff argued that the term “individual” should be construed to include LLCs because Section 2.101 of the Business Organizations Code provides that “‘a domestic entity has the same powers as an individual to take action necessary or convenient to carry out its business and affairs,’ including the power to ‘sue [and] be sued,’ ‘make contracts,’ and ‘incur liabilities.’” The court was unpersuaded by this argument. Likewise, the court rejected the plaintiff’s argument that the Texas Supreme Court would interpret the term “corporation” in Section 38.001 to include an LLC. The court discussed the nature of LLCs and acknowledged that LLCs and corporations have some similarities, but the court concluded that LLCs and corporations are distinct legal entities. Further, the court concluded that the history of Section 38.001 and its predecessor statute, Article 2226, supports the conclusion that the term “corporation” does not include an LLC. Article 2226 provided that “any person, corporation, partnership, or other legal entity having a valid claim against a person or corporation” could recover attorney’s fees against the “persons or corporation.” Thus, the court reasoned that Article 2226 clearly distinguished between corporations, on the one hand, which could both recover attorney’s fees and from whom attorney’s fees could be awarded, and “partnerships” and “other legal entities,” on the other hand, which could themselves recover attorney’s fees but from whom such fees could not be recovered. According to the court, because the term “corporation” in Article 2226 did not include a “partnership” or “other legal entity,” the term “corporation” in Section 38.001 likewise does not include a “partnership” or “other legal entity” such as an LLC. The court stated that cases applying Article 2226 in which courts awarded attorney’s fees against non-corporate entities did not squarely address the question. And even if Texas courts permitted attorney’s fees to be recovered from non-corporate business entities before codification, the court stated that the codification rather than the prior, repealed statute must be given effect when “specific provisions of a ‘nonsubstantive’ codification and the code as a whole are direct, unambiguous, and cannot be reconciled with prior law.” The court was also unpersuaded by Texas cases that have awarded attorney’s fees to non-corporate business entities under Section 38.001. In these cases, there was no indication that the question whether such an award was permitted under Section 38.001 was raised or considered. In sum, based on the plain meaning of the terms “individual” and “corporation,” the history of Section 38.001 and its predecessor, and the construction given to Section 38.001 by Texas courts of appeals and federal courts, the court predicted that the Supreme Court of Texas would hold that an LLC is neither an “individual” nor a “corporation” within the meaning of Section 38.001 and that a party cannot recover attorney’s fees from an LLC under Section 38.001.

## **B. Pre-Formation Transactions**

*Ganter Group, L.L.C. v. Choice Health Care, L.L.C.*, No. 11-12-00297-CV, 2014 WL 5562945 (Tex. App.–Eastland Oct. 31, 2014, no pet.) (mem. op.).

The court held that an LLC had standing to sue on a contract that was entered into before the LLC was formed. The Ganter Group, an Oklahoma business, entered into a contract with the defendant in 2008. Invoices from 2008 and 2009 were not paid by the defendant, and “Ganter L.L.C. d/b/a The Ganter Group” filed suit in 2010 to collect the balances due. The defendant argued that Ganter L.L.C. d/b/a The Ganter Group lacked standing and capacity to sue because it was an Oklahoma business that was not registered with the Texas Secretary of State as required by the Business Organizations Code. Without responding Ganter L.L.C. d/b/a The Ganter Group voluntarily nonsuited its claim. After the Secretary of State issued a certificate of formation for The Ganter Group, L.L.C., listing an Oklahoma resident as the sole manager, it filed this suit in 2012. In its petition, the plaintiff alleged that it was a Texas LLC doing business as The Ganter Group. The defendant argued in its motion to dismiss that The Ganter Group, L.L.C. d/b/a The Ganter Group could not have performed any contract it asserted in the lawsuit because, while its own pleadings showed it to be a Texas limited liability company, the official records of the secretary of state showed that it was not formed until 2011. The defendant attached the certificate of formation that was issued by the Secretary of State reflecting the filing date. Throughout its response to the defendant’s challenge to its capacity and standing, The Ganter Group, L.L.C. d/b/a The Ganter Group referred to itself as “Plaintiff” and referred to its rights and performance under the contract with the defendant. The defendant specifically adopted the plaintiff’s facts regarding the procedural nature of the case, and the court of appeals held that The Ganter Group had standing to bring the lawsuit. According to the court, “[t]o hold otherwise would be to hold that no assignee, collateral or otherwise, nor subsequent holder of an account or rights under a contract, could ever sue on it. Such holding would contravene Section 9.051(b)(2) of the Business Organizations Code.

Further, the ‘failure of a foreign filing entity to register does not ... affect the validity of any contract or act of the foreign filing entity.’ Tex. Bus. Orgs. Code § 9.051(c)(1).”

### C. Purpose Clause of LLC

*Doctors Hospital at Renaissance, Ltd. v. Andrade*, 13–15–00046–CV, 2015 WL 3799425 (Tex. App.–Corpus Christi-Edinburg June 18, 2015, no pet. h.).

The Andrades sued Dr. Lozano, Doctors Hospital at Renaissance, Ltd. (“DHR”) and DHR’s LLC general partner, alleging that Lozano was negligent in delivering their daughter, causing permanent injury to the child. The Andrades alleged that DHR and its LLC general partner were vicariously liable for the negligence of Lozano, who was a limited partner in DHR. As general partner of DHR, the LLC’s vicariously liability for Lozano’s actions depended solely on whether DHR could be held liable. DHR moved for traditional summary judgment, contending that it was entitled to judgment as a matter of law because Lozano “was not acting within the scope of [the] partnership” or “with the authority of the partnership” at the time of the alleged negligence. The trial court denied summary judgment but granted DHR’s request to file an immediate interlocutory appeal. Among several arguments addressed by the court of appeals was DHR’s argument that the “practice of medicine” clearly was not one of the purposes of DHR or the LLC. The court concluded that both the partnership agreement and the LLC’s articles of organization (which the court referred to as “articles of incorporation”) were broad enough that they did not necessarily exclude the practice of medicine. The provision of the partnership agreement describing the partnership’s purposes provided that one of the partnership’s purposes was “to own, develop, operate and engage in such other business activities as the General Partner may deem appropriate from time to time.” Thus, it did not establish as a matter of law that the practice of medicine was not one of the purposes for which the partnership was organized. The court applied the same rationale to DHR’s argument regarding the purposes stated in the LLC’s “articles of incorporation.” The purpose clause stated in its entirety:

3.01 The Limited Liability Company shall have the powers provided for a corporation under the Texas Business Corporation Act and a limited partnership under the Texas Revised Limited Partnership Act.

3.02 The purpose for which this limited liability company is organized is to transact any and all lawful business for which limited liability companies may be organized under the laws of Texas, including, but not limited to, the following:

- a. To carry on any business or any other legal or lawful activity allowed by law;
- b. To acquire, own, use, convey, and otherwise dispose of and deal in real or personal property or any interest therein;
- c. To manufacture, buy, sell, and generally deal in goods, wares and merchandise of every class and description;
- d. To buy, rent, sell, manufacture, produce, assemble, distribute, repair, and service any and all products or services in which the company desires to engage;
- e. To do such other acts as are incidental to the foregoing or desirable in order to accomplish the purpose for which the company was formed; and
- f. To have and exercise all rights and powers that are now or may hereafter be granted to a limited liability company by law.

3.03 The foregoing shall be construed as objects, purposes and powers, and enumeration thereof shall not be held to limit or restrict in any manner the powers hereafter conferred on this limited liability company by the laws of the State of Texas.

3.04 The company may, in its Regulations, confer powers, not in conflict with law, on its Managers and Members in addition to the foregoing and in addition to the powers and authorities expressly conferred on them by statute.

Thus, the purpose clause was very broad and did not purport to be exclusive and did not establish as a matter of law that the purpose of the LLC did not include the practice of medicine.

#### **D. LLC Property and LLC Membership Interest**

***AETC II Privatized Housing, LLC v. Tom Green County Appraisal District***, No. 03–13–00463–CV, 2015 WL 3918619 (Tex. App.–Austin June 24, 2015, no pet. h.) (mem. op.).

AETC II Privatized Housing, LLC (“AETC”), a Delaware LLC that provides multi-family housing for United States Military personnel and their families, sought an exemption from property taxes on certain improvements, but the appraisal district's review board denied the exemption, and AETC appealed to the district court. The district court denied AETC's motion for summary judgment and granted the appraisal district's motion for summary judgment, and AETC appealed.

One of AETC's arguments to support its entitlement to an exemption was that the U.S. holds equitable title to the improvements. The facts AETC asserted in support of this contention were: (1) of the three entities who formed AETC, the U.S.'s initial capital contribution was more than 96% of the total initial capital contributions made; (2) of the three entities who formed AETC, the U.S.'s percentage interest in AETC is 49%; (3) the ground lease with the Air Force is for a period of 50 years; (4) the base rent as defined by the lease is \$1.00; (5) at the end of the lease term either AETC must remove the improvements (military housing) or the U.S. will retain the improvements. The court concluded that these facts, even assuming all of them to be true, do not establish as a matter of law the present right of the U.S. to compel legal title, which is the standard for equitable title.

One of the grounds for summary judgment asserted by the appraisal district was that the U.S.'s participation in AETC did not convey government ownership because under the law applicable to LLCs, members have no ownership in property owned by the LLC. The appraisal district's summary judgment evidence showed that AETC was formed under Delaware law, which provides that an LLC interest is personal property and that a member has no interest in specific LLC property. Del. Code tit. 6 § 18–701. Texas law similarly provides. Tex. Bus. Orgs. Code § 101.106(b). Thus, the appraisal district met its summary judgment burden to show that the U.S., as a member of the LLC, had no interest in the personal property owned by the LLC, including the improvements at issue, and the burden shifted to AETC to produce evidence raising a fact issue, which it did not do.

***Fowler v. Montis***, No. 13-13-00581-CV, 2014 WL 6602288 (Tex. App.–Corpus Christi–Edinburg Nov. 20, 2014, no pet.) (mem. op.).

An individual, Montis, filed a forcible detainer action in justice court and received a judgment against Fowler in his own name. Fowler appealed to county court, and documents and pleadings in the county court revealed that an LLC was named as the landlord in the lease and owned the property. Montis testified that he was the sole owner of the LLC and owned the property, and the court entered a judgment in favor of Montis and the LLC. On appeal to the court of appeals, Fowler argued that Montis lacked standing and capacity to bring the forcible detainer action because the LLC owned the property.

The court of appeals agreed with Fowler that Montis lacked standing to bring the forcible detainer action. The court noted that a limited liability company is considered a separate legal entity from its members. Under Section 101.106 of the Business Organizations Code, a member of an LLC does not have an interest in any of the company's specific property, and Section 101.113 provides that a member of an LLC may be named as a party in an action by the LLC only if the action is brought to enforce the member's right against or liability to the company. Montis did not bring suit against Fowler to enforce his right against or liability to the LLC. Montis argued that he had standing because he signed the lease in the blank provided for the landlord. The court stated that lack of indication of representative capacity did not give him standing to bring LLC claims because a member of an LLC lacks standing to assert claims individually where the cause of action belongs to the company. Because the LLC was not made a party to the forcible detainer action and Montis lacked standing to bring it, the court vacated the county court's judgment and rendered judgment dismissing the forcible detainer action brought by Montis.

See also ***Haynes v. Haire***, No. 09–14–00011–CV, 2014 WL 5409053 (Tex. App.–Beaumont Oct. 23, 2014, pet. denied) (mem. op.), summarized below under the heading “Personal Liability of Member Under Agency or Other Law.”

See also ***In re Wilson***, No. 11–50396–rlj–7, 2014 WL 3700634 (Bankr. N.D. Tex. July 24, 2014), summarized below under the heading “Transfer Restrictions and Buyout of Member.”

See also *In re Prodigy Services LLC*, No. 14–14–00248–CV, 2014 WL 2936928 (Tex. App.–Houston [14<sup>th</sup> Dist.] June 26, 2014, no pet.) (mem. op.), summarized below under the heading “Charging Order.”

### **E. Fiduciary Duties and Oppression**

*Bigham v. Southeast Texas Environmental, LLC*, 458 S.W.3d 650 (Tex. App.–Houston [14<sup>th</sup> Dist.] 2015, no pet. h.).

An LLC sued one of its members and an attorney-in-fact for breach of fiduciary duty and other causes of action and obtained a judgment. On appeal, the court held that there was evidence to support the jury’s finding that the member who caused the LLC to file suit was authorized to do so, and there was sufficient evidence to support the jury’s finding that the defendants breached their fiduciary duties to the LLC.

Jeffrey Pitsenbarger (“Jeff”), Tracy Hollister, and two other individuals formed an LLC that purchased some property, which was unexpectedly declared a Superfund site a short time after its purchase. The LLC, as an innocent owner, could pursue contribution for the clean-up costs, and Hollister introduced Jeff to Bigham, whom Hollister represented possessed expertise in managing environmental litigation. The LLC entered into a power-of-attorney agreement with Bigham. Under the power-of-attorney agreement, Bigham was to manage the litigation. The LLC alleged that Bigham and Hollister breached their fiduciary duties by sabotaging the litigation, and the LLC obtained a favorable jury verdict and judgment.

The jury found that Bigham and Hollister had a relationship of trust and confidence with the LLC, that they failed to comply with their fiduciary duties, and that the breaches were committed with malice. The jury also found actual and exemplary damages. The court of appeals stated that it was undisputed that Hollister owed fiduciary duties as a member of the LLC. (Hollister’s fiduciary duties were not based on the power of attorney because he was not a signatory to the power of attorney even though he was designated under the power of attorney to receive a percentage of the LLC’s recovery in the environmental contamination litigation. Although the court referred to Hollister’s duties as relating to his status as member, an earlier portion of the opinion indicated that the LLC was manager-managed and referred to a Texas Franchise Tax Public Information Report signed by Hollister and listing Hollister as managing member.) Bigham owed the LLC fiduciary duties solely based on the power of attorney. Bigham and Hollister challenged the sufficiency of the evidence to support the jury’s finding that they failed to comply with their fiduciary duties. Although the LLC was the claimant, the jury question placed the burden on Bigham and Hollister to prove they complied with their fiduciary duties. As the question was phrased, Bigham and Hollister were required to establish all five factors listed: (1) the transaction in question was fair and equitable to the LLC; (2) they made reasonable use of the confidence that the LLC placed in them; (3) they acted in the utmost good faith and exercised the most scrupulous honesty toward the LLC; (4) they placed the interest of the LLC before their own, did not use the advantage of their position to gain any benefit for themselves in any position where their self-interest might conflict with their obligations as a fiduciary; and (5) they fully and fairly disclosed all important information to the LLC concerning the transaction. The court reviewed the evidence and concluded that it was sufficient to support the jury’s finding that Bigham and Hollister did not comply with their fiduciary duties. Based on the evidence, the jury could have concluded that Bigham and Hollister violated their fiduciary duties by threatening to provide harmful information to the defendants in the environmental litigation and withholding Hollister’s cooperation in the litigation when Hollister, as a member, had a duty to achieve an optimal result at trial, irrespective of whether he received any proceeds under the power of attorney.

*Macias v. Gomez*, No. 13–14–00139–CV, 2014 WL 7011372 (Tex. App.–Corpus Christi-Edinburg Dec. 11, 2014, no pet. h.) (mem. op.).

The minority members of an LLC obtained a summary judgment against Macias, the majority member, on Macias’s claim against the minority members for breach of fiduciary duty. Macias argued on appeal that he at least raised a fact issue as to whether the minority members owed him a fiduciary duty based on their exercise of active control over the LLC. The court of appeals affirmed the trial court’s summary judgment because Macias argued in the trial court that the minority members owed him a fiduciary duty as a matter of law, comparing the LLC to a partnership in which all partners owe one another a fiduciary duty. The court of appeals concluded that Macias did not fairly apprise the trial court of his “control” argument, and the summary judgment thus could not be

reversed on that basis. The court stated in a footnote that it offered no opinion as to whether an LLC's members who control activities of the LLC owe a fiduciary duty to majority members.

***Guevara v. Lackner***, 447 S.W.3d 566 (Tex. App.—Corpus Christi-Edinburg 2014, no pet. h.).

The court of appeals held that there was some evidence of the existence of an informal fiduciary duty owed by the two members of an LLC who were also managers to a third member who was not involved in the day-to-day affairs of the LLC, and there was also some evidence of breach of the duty and harm suffered by the third member.

Dr. Guevara sued Mark Lackner and Robert Lackner, fellow members of an LLC in which Dr. Guevara invested, for breach of fiduciary duty. The trial court granted a no-evidence summary judgment on this claim in favor of the Lackners. Based on a provision of the company agreement vesting sole control of the LLC in the Lackners as managers, Dr. Guevara alleged that the Lackners owed fiduciary duties of loyalty, good faith, fair dealing, full disclosure, and to account for all profits and property. Dr. Guevara alleged that the Lackners breached their duties by taking his money as a loan to purchase merchandise, conspiring to keep the profits, and suppressing information related to the transaction. He also alleged that the Lackners failed to use any business judgment in their dealings related to obligations owed by another member to the LLC. Dr. Guevara asserted that he was injured by the loss of funds he provided for the purchase of merchandise for the LLC and funds provided for other expenses of the LLC. The court noted that “Dr. Guevara’s status as a co-shareholder or co-member in a closely held corporation does not automatically create a fiduciary relationship between co-shareholders or co-members.” The court stated that Texas courts have recognized that an informal fiduciary duty may exist between shareholders of a closely held corporation under particular circumstances even though Texas courts have declined to recognize a broad formal fiduciary duty between majority and minority shareholders in closely held corporations. The court concluded that there was more than a scintilla of evidence of the existence of an informal fiduciary duty between the Lackners and Dr. Guevara, the breach of that duty, and injury to Dr. Guevara. The court pointed to evidence of the Lackners’ control based on the provision of the company agreement that vested sole control of the management, business, and affairs of the LLC in the Lackners as managers. There was also evidence that the Lackners’ role as managers gave them intimate knowledge of the daily affairs of the LLC and that Dr. Guevara did not have extensive knowledge of the operations and was not involved in the day-to-day operations. The summary-judgment evidence showed the Lackners did not disclose certain information to Dr. Guevara and that the Lackners’ made decisions without knowledge of relevant facts. There was also evidence that the funds provided by Dr. Guevara to the LLC were lost. According to the court of appeals, this evidence amounted to more than a scintilla of evidence of the elements of a claim for breach of an informal fiduciary duty.

***Bazan v. Munoz***, 444 S.W.3d 110 (Tex. App.—San Antonio 2014, no pet.).

The court of appeals held that the evidence supported a finding of an informal fiduciary duty by two LLC members to a third member based on their long-standing friendship and the trust placed in them by the third member. The court also concluded that the evidence was sufficient to support the jury’s finding that the two members breached their fiduciary duty by fraud by nondisclosure.

Munoz went into business with long-time friends, Carlo and Denise Bazan. The Bazans and Munoz made capital contributions to an LLC that purchased a night club, and the parties signed a company agreement under which Munoz and the Bazans each had a 50% interest in the business. Denise was designated the managing member, but she delegated the day-to-day operations to Carlo. Over time, Munoz became concerned about the finances of the business and eventually sued the Bazans for fraud by nondisclosure. Generally, no duty to disclose arises without evidence of a confidential or fiduciary relationship. The court stated that “Texas courts have not recognized a formal fiduciary relationship between majority and minority shareholders in a closely-held corporation, [but] they have recognized that—in the same manner that business partners owe each other and their partners a fiduciary duty—the nature of the relationships between shareholders in a limited liability company sometimes gives rise to an informal fiduciary relationship between them.” The jury found that the parties in this case had an informal fiduciary relationship, and the evidence supported that finding based on a long-standing friendship predating their business relationship and testimony by Carlo and Denise that Munoz went into business with them because of their personal relationship and gave them a great deal of control because of his trust in them. The company agreement did not expressly disavow fiduciary duties, and Denise and Carlo even testified that they owed Munoz a duty of loyalty and were obligated to protect his financial interests in the business as they would protect their own. The court of appeals concluded the evidence was sufficient to support the finding that the Bazans



committed fraud by nondisclosure by taking money from the business without the consent of Munoz. The evidence indicated that cash collected as cover charges was distributed to the Bazans without distributions to Munoz in violation of the company agreement, that the Bazans paid themselves salaries without Munoz's approval in violation of the company agreement, and that Munoz did not have an opportunity to discover the truth since he was not involved in the day-to-day operations of the business. The court concluded that the Bazans did not conclusively establish that Munoz waived his right to money removed from the business by the Bazans. While Carlo testified that Munoz engaged in waiver through his lack of interest in the business and its day-to-day operations, Munoz testified about his efforts to gain control over the business's finances. Thus, the jury was free to find that Munoz did not engage in waiver.

*Simulis, L.L.C. v. General Electric Capital Corporation*, 439 S.W.3d 571 (Tex. App.–Houston [14<sup>th</sup> Dist.] 2014, no pet.).

In the course of protracted litigation between Simulis, L.L.C. (“Simulis”) and General Electric Capital Corporation (“GE Capital”), the claims asserted by Simulis against GE Capital included a claim for breach of fiduciary duty. The parties agreed that Simulis was a Delaware LLC and that the Texas Business Organizations Code required the application of Delaware law to Simulis's claim that GE Capital breached a fiduciary duty to Simulis. Under the operating agreement of Simulis, GE Capital was a member of the LLC holding 20% of its units. Simulis alleged that GE Capital owed a fiduciary duty to Simulis as a member of the LLC and that it breached this duty through its agents and employees. GE Capital contended that it was entitled to summary judgment because it owed no fiduciary duty under Delaware law. GE Capital argued that it had contractual investor rights as a member but was not a manager of the LLC under the board structure of the LLC and had no authority to bind or manage the LLC. Further, GE Capital contended that it was not a controlling member because it owned only 20% of the LLC and appointed only one of four board members. Simulis argued that GE Capital was itself a member of the board and owed a fiduciary duty to the LLC because the operating agreement appointed a GE Capital officer as a member of the LLC's board. The court held that GE Capital did not owe a fiduciary duty to the LLC solely by virtue of its officer's position on the board of directors. The court based this conclusion on Delaware case law rejecting the proposition that a stockholder would automatically acquire the fiduciary obligations of a director when the director is affiliated with the stockholder. According to Delaware case law, the notion that a stockholder could become a fiduciary by attribution (similar to the tort doctrine of respondeat superior) would work an unprecedented, revolutionary change in Delaware law and would cause investors to be hesitant about seeking representation on a corporation's board of directors. The court stated that the reasoning from this case law applied in this context and foreclosed Simulis's claim for breach of fiduciary duty against GE Capital.

See also *Texas Ear Nose & Throat Consultants, PLLC v. Jones*, 2015 WL 3918130, \_\_ S.W.3d \_\_ (Tex. App. Houston [14<sup>th</sup> Dist.] June 25, 2015, no pet. h.), summarized below under the heading “Record Keeping Requirements and Access to Books and Records.”

#### **F. Personal Liability of Member Under Agency or Other Law**

*In re White-Robinson*, 777 F.3d 792 (5<sup>th</sup> Cir. 2015).

The court of appeals upheld the bankruptcy court's contempt order against an individual lawyer. The bankruptcy court had sanctioned the individual lawyer and her firm, a professional limited liability company, for bringing a frivolous and procedurally deficient motion. When the lawyer and her firm did not pay the ordered sanctions, the court held the lawyer and her firm in civil contempt. The lawyer argued that the bankruptcy court improperly held her jointly and severally liable for actions she performed as a member of her law firm, a Texas LLC. The court stated that Texas law only protects members from being liable for the LLC's obligations, not their own, citing Section 101.114 of the Business Organizations Code. The lawyer was held in civil contempt for her failure to pay sanctions she owed because of her own misconduct in prior bankruptcy proceedings. Thus, she was not protected by her membership in the LLC.

**Prent v. rJET LLC**, No. 01–14–00408–CV, 2015 WL 1020207 (Tex. App.–Houston [1<sup>st</sup> Dist.] Mar. 5, 2015, no pet. h.) (mem. op.).

The court of appeals held that the trial court erred in granting summary judgment holding the president of an LLC personally liable on a lease signed by the president of the LLC. The court concluded that the lease was signed by the president in her representative capacity and the language of the lease did not indicate an intent for the president to be individually liable. The motion for summary judgment did not allege that the president used the LLC to perpetrate a fraud for her personal benefit; therefore, the motion did not allege grounds to pierce the veil of the LLC.

The lessor of an aircraft sued Infinitus Aviation, L.L.C., and its president, Denise Prent, for breach of contract, alleging that Prent and the LLC breached the lease by refusing to make payments due under the lease, and the trial court granted summary judgment in favor of the lessor. On appeal, Prent argued that she signed the lease in a representative capacity on behalf of the LLC and thus was not personally liable for the payments due under the lease. The court of appeals recognized that a member or manager generally is not individually liable for the obligations of a limited liability company, citing Tex. Bus. Orgs. Code § 101.114 and Tex. Bus. Orgs. Code §§ 21.223, 21.224 (governing corporations), § 101.002 (extending sections 21.223–.226 to limited liability companies). The court cited case law extending to a professional limited liability company the following principle: “‘When it is apparent from the entire agreement that an officer of a corporation signed the contract on behalf of the corporation as an agent of the corporation, it is the corporation’s contract,’” and the court stated that “[a]gency law is based on the same premise—an agent is not personally liable on contracts made for a disclosed principal, in the absence of an express agreement to be bound.” Applying principles of contract construction and examining the lease as a whole, the court concluded that the lease was not ambiguous and that Prent executed it in her representative capacity. In the first paragraph of the lease, the lessor and “Infinitus Aviation LLC” were expressly identified as the parties to the agreement, and nothing in the body of the lease demonstrated that the parties intended for Prent to be individually or jointly liable on the lease. Although Prent was identified in one provision as “Lessee,” it was only in regard to her responsibility “as President” of the LLC to ensure operation of the aircraft within governing regulations. And the signature block on the same page showed that Prent executed the lease in her capacity as “President” of the LLC. Additionally, the court found nothing in the language of the lease that suggested the parties intended for Prent to act as a guarantor or to otherwise assume individual or joint liability on the lease.

Although the lessor included Prent’s bank statements and a spreadsheet of allegedly “commingled” funds in its summary-judgment evidence, it did not allege in its motion for summary judgment that Prent had used the LLC to perpetrate a fraud for her personal benefit. Therefore, the motion failed to allege grounds to pierce the veil of the LLC. See Tex. Bus. Orgs. Code §§ 21.223, 101.002. A motion for summary judgment must expressly present the grounds upon which it is made and must stand or fall on those grounds alone.

In sum, the lessor did not conclusively establish that it was entitled, as a matter of law, to judgment against Prent in her individual capacity on its breach-of-contract claim, and the trial court thus erred in granting the lessor summary judgment against Prent.

**Copeland v. D & J Construction LLC**, No. 3:13–CV–4432–N–BH, 2015 WL 512590 (N.D. Tex. Feb. 6, 2015).

The individual defendants in this case contended that they should be dismissed because all of the plaintiff’s claims related to the defendant LLC, and the individuals argued they were protected from liability under Sections 101.113 and 101.114 of the Texas Business Organizations Code (BOC). The court held that the pleadings were sufficient as to one individual defendant to support a claim of liability for breach of the LLC’s contract based on veil piercing, but the pleadings were not sufficient as to the other defendants. The pleadings were sufficient to support tort claims against the individual defendants based on the alleged wrongful conduct of the individual defendants themselves.

The plaintiff filed a suit against D & J Construction, LLC, Johnny Gray III, Darrell Gray, and Ethel Yolanda Gray, alleging claims for breach of contract and tort claims that included slander, libel, intentional infliction of emotional distress, and intentional interference with prospective economic advantage. The individual defendants contended that as members and managers of a Texas LLC, they could not be held liable for the LLC’s debts, obligations, or liabilities based on Tex. Bus. Orgs. Code §§ 101.113, 101.114. In response, the plaintiff alleged that the individual defendants could be held liable under the “corporate veil doctrine” because the LLC was

the alter ego of one of the individual defendants, and the defendants were operating a sham and committing fraud upon the public. The court stated that, in Texas, the corporate veil may be pierced where “(1) the [LLC] is the alter ego of its owners and/or shareholders; (2) the [LLC] is used for illegal purposes; and (3) the [LLC] is used as a sham to perpetrate a fraud.” The court explained that the traditional alter-ego doctrine was changed substantially by the codification of the doctrine in Section 21.223 of the BOC, which requires a showing that a shareholder or affiliate used the corporation to perpetrate an actual fraud for the direct personal benefit of the shareholder or affiliate in order to hold a shareholder liable for a contractual obligation of the corporation. The court noted that Texas courts have applied the statutory provisions on corporate veil piercing to LLCs.

The court held that the plaintiff’s pleadings, liberally construed, sufficiently alleged facts to support a finding of actual fraud for purposes of piercing the corporate veil. The standard for actual fraud is “dishonesty of purpose or intent to deceive.” Additionally, the actual fraud must relate specifically to the contract at issue. The plaintiff asserted generally that *all* of the individual defendants’ business model was to receive payment for work done but refuse to pay the workers who actually did the work. Because the plaintiff also alleged that the individual defendants agreed to hire the plaintiff for specific tasks on behalf of the LLC and then refused to pay him, the court concluded that he pled sufficient facts showing that the individual defendants had the intent to deceive him, showing actual fraud.

The plaintiff also sufficiently alleged that Johnny Gray III reaped personal benefit by alleging that Johnny Gray III was the sole member of the LLC defendant and used the debit cards of the business for his personal expenses. Additionally, the plaintiff alleged that Johnny Gray III perpetrated fraud by hiring workers and refusing to pay them once the work was completed. The plaintiff also contended that, Johnny Gray III, as the sole member of the LLC, did not obtain the required liability insurance for the LLC and that the lack of formality was additional evidence that the LLC was a mere front for Johnny Gray III to perpetuate fraud. Liberally construing the plaintiff’s assertions as required under a Rule 12(b)(6) analysis, the plaintiff sufficiently alleged actual fraud and that Johnny Gray III used the LLC to perpetrate the fraud to allow piercing the LLC’s corporate veil.

The plaintiff did not, however, provide facts showing that Darrel Gray and Ethel Yolanda Gray perpetrated the fraud for direct benefit to themselves. The plaintiff did not allege that Darrell Gray or Ethel Yolanda Gray used the LLC’s resources for personal gain, or that they were members of the LLC. The plaintiff conceded that the sole member of the LLC was Johnny Gray III. The plaintiff alleged generally that the individual defendants filed with different cities and municipalities three separate business entities at the same address without proper liability insurance for the purpose of evading suits, judgments, garnishments, and liens, and that the defendants were committing fraud upon the public, but the plaintiff did not allege any facts showing that the LLC was an alter ego of Darrell Gray or Ethel Yolanda Gray.

The plaintiff alleged various tort claims against the defendants based on allegations that the individual defendants made defamatory statements about him during telephone calls and in text messages. The court stated the principle that an agent of an LLC is personally liable for his own fraudulent or tortious acts, even when acting within the course and scope of his employment, relying on case law addressing liability of corporate officers and employees for the wrongdoing of the officers or employees, even when acting in their representative capacities. The court further stated that the BOC supports distinguishing tort suits from contract suits when finding personal liability of a corporate officer, stating that Sections 101.114 and 21.223 “support the conclusion that, in cases of misrepresentation or fraud (as opposed to simple breach of contract), a corporate agent may be held personally liable for his own misrepresentations.” The plaintiff’s pleadings described allegedly false and defamatory statements in phone calls and text messages to the district attorney and vendors. The court characterized the alleged statements made as “intentional tortious acts akin to ‘fraudulent statements or knowing misrepresentations’” that lead to individual liability. Thus, the court held that the plaintiff sufficiently pled specific tortious actions by the individual defendants that could subject them to personal liability.

***Haynes v. Haire***, No. 09–14–00011–CV, 2014 WL 5409053 (Tex. App.–Beaumont Oct. 23, 2014, pet. denied) (mem. op.).

Haynes, as sole manager of Vair Resources, LLC (“Vair”), filed an action to quiet title against Maurice Haire and Lisa Haire. The Haires filed a counterclaim for declaratory judgment and improper redemption. After a bench trial, the trial court signed a judgment in favor of the Haires. One of the Haynes’s arguments on appeal was that the trial court improperly entered judgment against him in his individual capacity. The court stated that the record indicated that Haynes was before the trial court in his official capacity as sole manager of Vair. In its

judgment, the trial court stated, “all relief requested by Plaintiffs/Counter–Defendants Stone Haynes and Vair Resources, LLC, shall be DENIED” and that “Stone Haynes and Vair Resources, LLC have no property rights” in the property. The court pointed out that, as sole manager of Vair, Haynes had no personal interest in the property owned by Vair. Tex. Bus. Orgs. Code § 101.106(b). Furthermore, in his capacity as manager of the LLC, Haynes was bound by the judgment against the LLC. Because Haynes was not before the trial court in his individual capacity, had no rights in the property, and was bound by the judgment in his official capacity, the court could not say that the judgment was binding on Haynes individually or that Haynes would suffer any harm from the manner in which the judgment was phrased.

### **G. Authority of Member, Manager, or Officer**

*Penny v. El Patio, LLC*, 2015 WL 3543056, \_\_ S.W.3d \_\_ (Tex. App.–Austin 2015, no pet. h.).

In this dispute over the authority of an LLC’s operating manager to hire an attorney to assert claims on behalf of the LLC against some of its members and affiliates of the members, the court concluded that the trial court did not err in concluding that the operating manager had authority to hire the attorney on behalf of the LLC without a vote of the members.

This lawsuit started out as a suit to set aside an LLC member’s foreclosure on the LLC’s property after the LLC defaulted on a loan to the member, but the suit expanded to include additional parties and claims by the LLC against other members relating to the management of the LLC’s property before the foreclosure. The principal issue on appeal was whether the operating manager of the LLC had authority to hire an attorney for the LLC to assert claims against other members of the LLC and affiliates of those other members.

The LLC at issue was formed by several investors, including David Penny, Richard Cheroske, and Stephen Hyde, to purchase and own a hotel. Hyde was named as the LLC’s operating manager, and the LLC hired Blue Castle Property Management, LLC (“Blue Castle”) to operate and manage the motel’s day-to-day business. Blue Castle was owned by 190 Orange Avenue, Inc. (“190 Orange”), which was owned by Penny and Cheroske. Penny and Cheroske filed this suit as a derivative action to set aside a foreclosure on the LLC’s property, and the LLC intervened to assert several claims against Penny, Cheroske, Blue Castle, Blue Castle’s accountant, and 190 Orange for conversion, theft liability, breach of fiduciary duty, breach of contract, fraud, and other causes of action in relation to the management of the motel. After the claims relating to the foreclosure were resolved and the foreclosure was set aside, the claims against Penny, Cheroske, and the other third-party defendants remained. Penny, Cheroske, and the other third-party defendants filed a motion to require the LLC’s attorney to show the trial court that he had authority to prosecute the suit against them on the LLC’s behalf. The trial court ruled that the LLC’s attorney had authority to prosecute the suit, and Penny, Cheroske, and the other third-party defendants failed to respond to the LLC’s discovery requests and motions thereafter. The trial court eventually struck their pleadings and awarded the LLC judgment on all its claims. Penny appealed from that judgment.

On appeal, Penny challenged the trial court’s determination that the LLC’s attorney had authority to prosecute the suit. Penny argued that Hyde’s position as operating manager of the LLC did not vest him with the authority to hire an attorney to prosecute the LLC’s claim because the LLC’s operating agreement did not contain express language authorizing litigation and because Hyde lacked specific approval from a majority in interest of the members to conduct the litigation. Penny relied on Texas cases that he said stood for the proposition that the officers of a corporation do not have authority to employ counsel or initiate litigation in the absence of either approval of the board of directors or express authorization in the bylaws.

The court disagreed with Penny’s interpretation of the LLC’s operating based on the plain language of the agreement. The agreement named Hyde as the initial operating manager as follows: “Management of the Company shall be vested in the Members who shall serve as Operating Managers of the Company, initially Stephen Hyde.” Though the provision of the operating agreement regarding management of the LLC did not reference litigation, it gave the operating manager sole and exclusive control over the company’s business and granted to the operating manager all the powers and rights needed to conduct that business as follows:

The Company shall be managed by the Operating Managers, who shall be paid a fee for serving as Operating Managers, and the conduct of the Company’s business shall be controlled and conducted solely and exclusively by the Operating Managers in accordance with this Agreement. In addition to and not in limitation to any rights and power conferred by law or other provisions

of this Agreement, the Operating Managers shall have and may exercise on behalf of the Company *all powers and rights necessary, proper, convenient or advisable to effectuate and carry out the purposes, business and objectives of the Company, and to maximize Company profits.* (Emphasis added.)

The court said it was hard to imagine a broader grant of managerial authority, and protecting the LLC's interests by asserting the claims asserted in this case certainly fell within the purposes, business, and objectives of the company according to the court.

Even assuming the LLC's operating agreement did not expressly grant Hyde the authority to conduct litigation on the LLC's behalf, the court said that the cases Penny cited in support of his argument did not inform the court's decision. The cases cited by Penny (for the proposition that Texas law requires express language in the bylaws or approval from the board of directors for an officer to litigate) involved corporations rather than LLCs and were decided under the now recodified article 2.31 of the Texas Business Corporation Act. The current version of article 2.31 is located in Title 2 of the Texas Business Organizations Code (BOC) and is specific to for-profit corporations. Thus, the provision does not apply to a limited liability company. Moreover, the court pointed out that the BOC provisions applicable in this case provide that, unless the entity's governing documents provide otherwise, an LLC's affairs are managed and directed by managers.

Penny next argued that the second sentence in the following paragraph of the operating agreement required that all actions by the LLC must be voted on and approved by a majority in interest of the member owners:

Management of the Company shall be vested in the Members who shall serve as Operating Managers of the Company, initially Stephen Hyde, or a company controlled by him. Except as otherwise provided in this Agreement, *all decisions of the Operating Managers shall be by a majority in interest of the Members.* All Operating Managers must be Members of the Company, or a company controlled by a member....(Emphasis added.)

The court rejected this argument based on the agreement as a whole and harmonizing its provisions with an eye to the particular business activity sought to be served. The court concluded that the language relied on by Penny merely explained the method by which the managers reach a decision in a situation where there is more than one operating manager and they are not in complete agreement. Staying within the context of the first sentence (which provides that management of the company will be vested in operating managers, that only members can serve as operating managers, and that Hyde will be the first member to serve as operating manager), the court said the second sentence explains that the *operating managers'* decisions, i.e., "decisions of the Operating Managers," are achieved based on their membership interest. The court stated that Penny's interpretation, which would require a majority vote on *every* company decision, would "render the operating agreement unreasonable, inequitable, and oppressive." The court said that Penny's interpretation would make the agreement's creation of operating managers and their duties meaningless given that a member vote would be required for any and every action. In other words, there would be no need for operating managers if all decisions must be made by the members. In addition, Penny's interpretation would render redundant the agreement's requirement that a majority in interest of the members approve the selling or refinancing of real property.

In sum, the court determined that the operating agreement vested Hyde with authority to litigate on the LLC's behalf, and the trial court thus did not err in holding that the LLC's attorney satisfied his burden to show his authority by offering the LLC's operating agreement and Hyde's affidavit.

***Bigham v. Southeast Texas Environmental, LLC***, 458 S.W.3d 650 (Tex. App.–Houston [14<sup>th</sup> Dist.] 2015, no pet. h.).

An LLC sued one of its members and an attorney-in-fact for breach of fiduciary duty and other causes of action and obtained a judgment. On appeal, the court held that there was evidence to support the jury's finding that the member who caused the LLC to file suit was authorized to do so, and there was sufficient evidence to support the jury's finding that the defendants breached their fiduciary duties to the LLC.

Jeffrey Pitsenbarger ("Jeff"), Tracy Hollister, and two other individuals formed an LLC that purchased some property, which was unexpectedly declared a Superfund site a short time after its purchase. The LLC, as an innocent owner, could pursue contribution for the clean-up costs, and Hollister introduced Jeff to Bigham, whom

Hollister represented possessed expertise in managing environmental litigation. The LLC entered into a power-of-attorney agreement with Bigham. Under the power-of-attorney agreement, Bigham was to manage the litigation. The LLC alleged that Bigham and Hollister breached their fiduciary duties by sabotaging the litigation, and the LLC obtained a favorable jury verdict and judgment.

On appeal, Bigham and Hollister argued that the evidence conclusively established that Jeff lacked authority to file the suit on the LLC's behalf, relying in part on provisions of the now-expired Texas Limited Liability Company Act that generally provide that managers may take actions on behalf of an LLC by obtaining a vote of a majority of the managers at a meeting where a quorum is present or a vote or consent of a majority of the managers without a meeting. Bigham and Hollister asserted that the evidence showed that, even if Jeff were a manager, he did not obtain the vote or consent of the majority of the managers. Because the jury was not instructed or given evidence regarding this statutory standard, however, the court did not consider it. The court measured the sufficiency of the evidence against the charge submitted. The broad question submitted to the jury asked generally whether Jeff had "authority" to file the suit. Bigham and Hollister pointed to the articles of organization of the LLC, which provided that the LLC was manager-managed. Bigham and Hollister argued that Jeff was not a manager when the suit was filed in September 2007 based on a Texas Franchise Tax Public Information Report signed by Hollister and filed by the LLC in April of 2007. The report listed Hollister as managing member and the two owners who were not involved in this case as managers or officers, but the report did not list Jeff as a manager or officer. The court disagreed that this evidence prevented a reasonable jury from finding that Jeff had authority to file the suit. That the articles of organization provided for management of the LLC by managers did not conclusively establish that only a manager could authorize a suit. There was evidence that Jeff was a member or owner of the LLC, and Jeff testified that he had authority to file the suit. Additionally, even if the authorization of a manager were required, there was conflicting evidence regarding whether Jeff was a manager. Jeff testified that the role of manager evolved to him by 2000 or 2001 and that the information in the Texas Franchise Tax Public Information Report was incorrect. In addition, Bigham referred to Jeff as the registered manager of LLC in an email in 2004. Thus, the court concluded the evidence was sufficient to support the jury's answer to the question as submitted.

*Twenty First Century Holdings, Inc. v. Precision Geothermal Drilling, L.L.C.*, No. 03-13-00081-CV, 2015 WL 1882267 (Tex. App.—Austin Apr. 23, 2015, no pet. h.) (mem. op.).

The court of appeals concluded that a manager of an LLC did not have authority to enter into a settlement agreement releasing the LLC's claims against an entity owned by the manager because he was an interested governing person, and the provisions of the Business Organizations Code regarding approval of a transaction between an LLC and an entity in which a governing person has a financial interest were not met.

DeMarco and Denny formed an LLC to perform drilling work. DeMarco was 49% owner and Denny was 51% owner of the LLC, and both were managers. The LLC contracted with American Geothermal Systems, Inc. ("AGSI"), a company owned by DeMarco, and disputes arose between Denny and DeMarco over the drilling work and payment. Denny filed suit in the justice court on behalf of the LLC against AGSI seeking to recover \$8,000 from AGSI. Denny and DeMarco eventually reached a settlement agreement in principle, but additional disputes arose regarding the operation of the LLC during the final settlement negotiations. DeMarco or AGSI's counsel drafted a new settlement agreement, which DeMarco signed on behalf of both the LLC and AGSI. DeMarco then filed a nonsuit of the LLC's case. On motion by the LLC, the justice court vacated the dismissal it had entered after DeMarco filed the nonsuit. AGSI sought to compel arbitration based on an arbitration clause in the settlement agreement. The justice court denied the motion for arbitration on the basis that the settlement agreement was invalid and also sanctioned DeMarco and the attorney for AGSI, whom the record showed represented DeMarco in virtually all matters related to the dispute and lawsuit. After unsuccessfully appealing to the county court, AGSI appealed to the court of appeals.

On appeal, AGSI contended that DeMarco had authority to execute the settlement agreement, the arbitration provision in the settlement agreement was thus valid, and the county court abused its discretion in not compelling arbitration. AGSI argued that DeMarco, as a manager of LLC, had authority to act on behalf of LLC in drafting and signing the settlement agreement that included the arbitration provision because the managers of an LLC are its "governing authority," and each governing person vested with actual or apparent authority by the governing authority is an agent of company for purposes of carrying out the company's business. Tex. Bus. Orgs. Code §§ 101.251, 101.254. The LLC argued that DeMarco's actions are controlled by Tex. Bus. Orgs. Code § 101.255

(“Contracts or Transactions Involving Interested Governing Persons”), which provides, in relevant part, that an otherwise valid and enforceable contract or transaction between an LLC and a governing person or an entity in which a governing person is a managerial official or has a financial interest “is valid and enforceable, and is not void or voidable” if it is (1) known by or disclosed to and authorized by the “governing authority,” i.e., the managers, or (2) fair to the company. The LLC argued that DeMarco, as the sole owner of AGSI, was an “interested governing person” and that the settlement agreement between AGSI and the LLC thus had to be (1) known by or disclosed to and authorized by the managers, which included Denny, or (2) fair to the LLC. DeMarco did not dispute that DeMarco entered the settlement agreement without informing Denny and that Denny did not otherwise know of the agreement. The LLC contended that the settlement agreement was not fair to the LLC because it settled its breach-of-contract claim for no payment of money when the earlier settlement agreement had called for payment of \$5,100 to the LLC. The court of appeals agreed with the LLC that the settlement agreement did not meet either of the requirements of Section 101.255 of the Business Organizations Code. As the sole owner of AGSI, DeMarco was an “interested governing person” under the plain language of the statute. It was undisputed that DeMarco acted without consulting or even informing Denny in drafting and signing the settlement agreement. Further, unbeknownst to Denny, the settlement agreement released the LLC’s claims against AGSI and DeMarco in return for no consideration other than AGSI’s release of claims against the LLC, despite a prior offer of \$5,100. Thus, the settlement agreement, with the arbitration clause, could not be construed as “fair” to the LLC within the plain meaning of the term. The court cited sources defining “fair” as “characterized by honesty and justice” or “free from fraud, injustice, prejudice, or favoritism.” On the record before the court, it could not conclude that the parties entered into a valid and enforceable agreement to arbitrate.

#### **H. Transfer Restrictions and Buyout Provisions**

*In re Wilson*, No. 11–50396–rlj–7, 2014 WL 3700634 (Bankr. N.D. Tex. July 24, 2014).

The trustee sought permission to sell by auction 200 certificated LLC membership units held in the name of the debtor, and the debtor and another member argued that the sale was subject to valid transfer restrictions in the company agreement. A creditor of the debtor made an offer for the units and favored auctioning the units. Given the nature of the asset as defined by state law; the terms of the transfer restrictions in the company agreement; the motivations and intentions of the parties in their respective roles as members or creditors; and the procedures that had been employed thus far (which did not include notice to other members as provided by the transfer restrictions), the court authorized the trustee’s sale of the debtor’s 200 units at a sealed-bid auction of which the members would have notice and in which the members would have the opportunity to match the high bid consistent with the transfer restrictions in the company agreement. The court stated that the nature of the interest sold was defined by the Texas Business Organizations Code as it applies to the assignment or transfer of a member’s interests in an LLC.

The Wilsons and an LLC in which Mr. Wilson held 200 units both filed Chapter 11 bankruptcy petitions after a large judgment was obtained against the Wilsons and the LLC. The Wilsons’ case was converted to a Chapter 7 case, and the judgment creditor, Custom Food Group, LP (“CFG”) sought to purchase Mr. Wilson’s units in the LLC for \$7,500. The trustee sought permission to sell the 200 units to CFG for \$7,500, subject to other competing bids coming in before a specified deadline. Wilson and another member, Rogers, objected to the sale on the basis of transfer restrictions contained in the company agreement. As a member and interest holder, Rogers argued that he could invoke the transfer restrictions affording him the first right to purchase the units at a price offered by an outside bidder. Rogers also pointed out that he and other members of the LLC were not provided with timely notice of any sale by the trustee.

The company agreement for the LLC (both an original agreement between the initial members and an amended and restated company agreement adopted when an additional member was admitted under the LLC’s reorganization plan) provided the structure, makeup, and mechanics of the LLC. It set forth the LLC’s purpose to conduct a lawful business; provisions regarding the managers of the LLC—their rights, duties, potential removal, and replacement; requirements regarding regular and special meetings of the company; the identity and ownership (by units and percentage) of the member-managers and how their capital accounts were created and accounted for; provisions regarding the transfer of a membership interest; and provisions regarding dissolution and liquidation. Of particular relevance in this case was Article VII, which addressed potential transfers of a member’s interest. The transfer provisions provided that any member who sought to transfer his interest must first provide written notice

to the other members of the proposed transfer, and the other members then had the option of acquiring the interest proposed to be transferred at “a price equal to the lesser of the Book Value of the Interest and the amount offered by the proposed transferee.” The “Book Value of the Interest” was a defined term and was to be determined by a CPA. If multiple non-transferring members sought to acquire the interest, they did so on a pro rata basis. The company agreement did not require additional capital contributions or loans by the members.

The trustee proposed to auction Wilson's 200 units to realize their value as an estate asset, and she did not propose to sell any particular allocable interest or set of interests represented by the units—such as economic, management, voting, right to information, etc. The trustee simply sought to sell what she could sell to liquidate the units' value. CFG, the largest creditor in the case, advocated that the trustee hold a private sale in the form of an auction between CFG and the members of the LLC. Wilson conceded that the trustee could attempt to sell his 200 units (despite an exemption claim he had made), but argued that CFG's bid of \$7,500 was not a true value for the units because the bid was motivated by CFG's desire to commit mischief as a competitor of the LLC. CFG denied this accusation. Rogers and the LLC were aligned with Wilson and argued that the transfer restrictions in the company agreement applied to any proposed transfer or assignment of a member's units and that the restrictions granted the other members the first right to purchase Wilson's units at the lesser of CFG's bid price of \$7,500 or the book value as defined in the company agreement. Rogers further proposed that he simply match CFG's offer of \$7,500, and, in so doing, would waive any problems regarding notice of the sale as well as any right to purchase for book value (which he argued was probably zero). The court found no reason not to approve Rogers' proposal if either the original or amended and restated company agreement applied and the transfer restrictions controlled. CFG, however, argued that neither the company agreement nor the restriction on transfer of members' units should apply in this case.

CFG first argued that there was no valid and controlling company agreement because the restated company agreement misstated the number of units owned by the members and was thus rendered invalid. (The number of units recited in the agreement did not match the number of units shown on the newly issued certificates, but the percentages recited in the agreement matched the numbers on the certificates.) Further, it argued that the company agreement was not specifically approved by the court. The court stated that this argument attempted to avoid Wilson's claim that the restrictions controlled because the Texas Business Organizations Code specifically endorses such restrictions. CFG responded that the statutory provision relied upon applies to corporations and not to LLCs. As a follow-on argument, CFG contended that Texas case law indicates that such restrictions should not be enforced as a way to prevent an involuntary sale such as the trustee's proposed auction here. At a minimum, according to CFG, Texas law authorizes an assignment of the economic benefit to be derived from the 200 LLC units, and this economic benefit could be sold by the trustee.

With regard to CFG's argument that the company agreement was invalid based on a misstatement in the number of units owed by the members, the court “fail[ed] to appreciate why an easily corrected number in a company agreement cannot be easily corrected without disavowing the agreement.” No authority was provided to the court showing the necessity of invalidating the existence of a company agreement. The court refuted an argument by CFG that the legend regarding restrictions contained on the cancelled certificates did not appear on the newly issued certificates. The restrictions were referenced on the face of each of the newly issued certificates and stated in italics: “Transfer of these Units is subject to restrictions in the Operating Agreement/ Company Agreement/ Regulations for this Limited Liability Company.” The court further pointed out that, regardless of the existence of the legend on the certificate, CFG was made aware of the restrictions during the proceedings.

The court next addressed the enforceability of the transfer restrictions under the Texas Business Organizations Code (“BOC”). The court characterized the issue as whether the restrictions in this LLC were enforceable. No argument was made that the restrictions were generally unenforceable. The court found no provision in Title 3 of the BOC, which applies to LLCs, that limited the use or allowance of the restrictions at issue. The court noted further that membership units in an LLC may be assigned, but the assignment does not entitle the assignee to participate in management, to become a member, or to exercise the rights of a member. Tex. Bus. Orgs. Code § 101.108. The assignee is entitled to an allocation of the economic attributes—income, gain, loss, distributions, etc.—but only to the extent that such benefits have been assigned, and an assignee may become a member on approval of all members. *Id.* § 101.109. Furthermore, the court's review of Chapter 101 of the BOC revealed that an LLC may, after formation, issue membership units to any person with approval of all members pursuant to Section 101.105, and that the membership interests may be subject to a charging order upon application of a judgment creditor of a member under Section 101.112. The court explained that a charging order is a lien on



the interest that cannot be foreclosed but does entitle the lienholder-creditor to receive any distribution to which the judgment debtor would be entitled. The charging order is the exclusive remedy by which a judgment creditor of a member may satisfy a judgment out of the membership interest. Thus, absent the restrictions, the court said it appeared that the trustee could sell an interest in Wilson's units to CFG that would then allow CFG to recover certain economic benefits attributable to Wilson's 20% interest.

CFG contended that the trustee was an assignee of Wilson's interests in the LLC and that, as an assignee, the trustee held Wilson's rights to distributions deriving from his 20% membership interest pursuant to Section 101.108 of the BOC and could sell the distribution rights. But the court pointed out that Section 541(a) of the Bankruptcy Code expressly provides that "all legal or equitable interests of the debtor in property as of the commencement of the case" constitute estate property. Since all interests attributable to Wilson's ownership in the units passed to the estate for administration by the trustee upon the bankruptcy filing, the trustee was subject to applicable law, including the BOC, concerning any proposed sale or transfer of Wilson's units. The BOC provides that any assignment of a member's interest grants to the assignee limited rights, i.e., the assignor's allocation of economic benefits, to the extent such items are assigned, and rights to reasonable information and inspection of books and records of the company. Tex. Bus. Orgs. Code § 101.109. The court also reiterated that the BOC provides for a judgment creditor of a member to obtain from a court a charging order that creates a non-forecloseable lien against the interest, which is the exclusive remedy of a judgment creditor against a member's interest. The court held that the transfer restrictions contained in the company agreement limited Wilson's, and thus the trustee's, ability to sell the units, but also provided that Wilson, as a member, could transfer the entirety of his interests represented by the units. The transfer restrictions specifically stated that they applied to "all or any portion of the Member's entire membership interest," and a "membership interest" was defined to mean such "Member's interest in profit and loss, capital, management, right to vote, and any other interest provided in the Company Agreement to such Member." The transfer by a member of the entirety of such member's interest was subject to the other provisions contained in the company agreement that dictated that other members had a first right to purchase the units at the lesser of the proposed purchase price or the defined book value. This option, CFG contended, undermined any sale, which the court found to be a legitimate concern in light of the assumed book value of the units. The question was whether or to what extent the transfer restrictions should apply since the apparent effect would be to prevent the trustee from recovering anything for the 200 units. That result would be unfair according to the court, especially given the rights of a judgment creditor to impose a charging order on the 200 units. Here, however, the trustee sought to sell the units rather than seeking a charging order or seeking to sell an asset that was subject to a charging order. As a bankruptcy trustee, the trustee was required to administer the asset, i.e., to reduce it to money in a manner as expeditiously as is compatible with the best interests of all parties. 11 U.S.C. § 704(a)(1).

CFG made the alternative argument that the company agreement was deemed rejected under Section 365(d)(1) of the Bankruptcy Code by the trustee's failure to timely assume the agreement as an executory contract, but the court did not construe the company agreement to be an executory contract and thus rejected this argument. First, neither the trustee nor the other members, i.e., the parties to the agreement, contended that the agreement was an executory contract. Second, all the parties, including CFG, were parties to the confirmation hearing on the Chapter 11 plans of both the LLC and the Wilsons, and no party then took the position that the LLC's company agreement was an executory contract. The Wilsons served as the day-to-day managers of the company while the other members were mostly passive investors. By the terms of the company agreement, they were each designated to serve as managers. The members, subject to the requisite votes, were each granted certain powers—to manage the company, to enter into contracts, to take certain actions concerning major transactions of the company or significant changes in the company's structure. They were not obligated to make additional capital contributions. They in essence had the right to participate in the business and affairs of the company, but were not required to do so. The court did not consider these rights to be executory duties giving rise to an executory contract.

The court concluded that the trustee should be able to realize fair value for Wilson's 200 units in the LLC. The transfer restrictions in the company agreement, as applicable here, potentially undermined that goal. Rogers' proposal to waive the option to purchase at book value addressed the problem, and the other members' right to match a proposed purchase by CFG or other third party would not prevent the trustee's ability to obtain fair value. The court was not offended by the \$7,500 purchase price, and the court thus exercised the discretion it had as a bankruptcy court to strike a balance between fairness, finality, integrity, and maximization of assets. The court authorized the trustee's sale of Wilson's 200 units and stated that the nature of the interest sold was defined by the

BOC as it applies to the assignment or transfer of a member's interests in an LLC. The sale was to be made by sealed bids to be submitted at a time and location specified by the trustee. The members of the LLC were required to be provided notice of the sale and an opportunity to bid, and the members had the opportunity to match the high bid as provided for in the company agreement.

## I. Record Keeping Requirements and Access to Books and Records

*Texas Ear Nose & Throat Consultants, PLLC v. Jones*, 2015 WL 3918130, \_\_ S.W.3d \_\_ (Tex. App. Houston [14<sup>th</sup> Dist.] June 25, 2015, no pet. h.).

In this dispute between a departing member of a medical practice organized as a professional limited liability company and the other members, the court of appeals held that the departing member's membership in the LLC did not terminate when he left the medical practice, that the departing member was entitled to recover attorney's fees from the PLLC but not from the individual members in connection with denial of his right to access the PLLC's books and records, and the departing member's oppression claim should be remanded for further proceedings in the interest of justice in light of the decision of *Ritchie v. Rupe* after the trial of this case.

Jones was a founding member of Texas Ear Nose & Throat Consultants, PLLC ("TENT"), a closely held medical practice. Three basic documents governed the relationship between each member, TENT, and the other members: (1) a member agreement, (2) regulations, and (3) a physician's employment agreement (one for each member). In November 2009, relations between Jones and the other members became strained, and the member who served as president of TENT accused Jones of undermining the practice and told Jones to leave by January 2010. Jones delivered his notice of retirement two days later on November 19, 2009, and his last day of work for TENT was December 15, 2009, after which he went to work for Baylor College of Medicine. In February 2010, Jones sued TENT and the other members alleging breach of the agreements between them, shareholder oppression, and denial of access to the practice's books and records. TENT and the other members counter-claimed against Jones for breach of contract. Based on an extensive jury verdict, the trial court awarded each side breach-of-contract damages and related attorney's fees, awarded Jones additional attorney's fees on his claim seeking access to books and records, and ordered the other members to buy out Jones's membership as a remedy for shareholder oppression. TENT (and the other members) appealed.

The first several issues addressed by the court of appeals related to the appellants' contentions that the evidence did not support the jury's findings that TENT breached Jones's employment agreement, that Jones was entitled to \$374,694.01 in "ancillary income" due to the alleged breach, and that Jones's own breach of the agreement was excused. The court of appeals analyzed the terms of the employment agreement and the evidence and concluded that the evidence supported the jury's findings.

The court of appeals next addressed the appellants' challenge to the jury finding that Jones was still a member of TENT at the time of trial. The appellants' argued that Jones's status was proven as a matter of law and that the trial court thus should have disregarded the jury's finding. The appellants relied on the terms of the LLC regulations and the member agreement for their contention that Jones's membership was terminated when he announced his retirement and that his interest was then "involuntarily transferred" back to TENT. According to the appellants, Jones had no membership for the trial court to order to be bought out at the time of trial. The court of appeals concluded that the provision of the regulations relied on by the appellants did not exactly provide what the appellants argued it did. The appellants argued that the regulations provided that the retirement of a member immediately terminated the member's membership in TENT, but the court noted that the following provision relied upon by the appellants did not say what became of a member's ownership interest on retirement:

The death, retirement, resignation, or dissolution of a Member, or the period for the duration of the Company [i.e., TENT] as stated in the Articles [i.e., TENT's Articles of Organization] expires, or the occurrence of any other event which terminates the continued membership of a Member in the Company (a "Dissolution Event"), dissolves the Company unless the remaining Member(s) unanimously consent in writing to the continuation of the business of the Company ("Unanimous Consent").

The effect of retirement on a member's interest was covered by the member agreement, which set forth numerous occurrences that could result in the involuntary transfer of a member's ownership interest in TENT as

well as procedures for handling those transfers. The occurrences listed included death of the member, termination of the member's employment with the medical group with or without cause, termination of employment by the member with or without cause, and "Total and Permanent Retirement of the Member from the Practice of Medicine and from the Medical Group." Another provision of the member agreement provided various methods of valuation of a member's interest depending on the nature of the termination of membership. The appellants argued that Jones's attempt to retire on November 19, 2009 was ineffective under the member agreement because Jones did not at that time retire from the practice of medicine. They argued that Jones instead simply terminated his employment with TENT without cause, which according to the member agreement would entitle him to \$10 as payment for his interest in TENT. However, this argument glossed over the jury's finding that the appellants improperly terminated Jones's employment before his attempted retirement. In any event, the termination of Jones's employment with TENT, whether a retirement, resignation, or termination, did not determine whether he retained his membership interest in TENT. Rather than being automatic on the occurrence of one of these events, specific steps had to be taken under the member agreement before a transfer could be effected. Occurrence of any of the listed events triggered successive rights of first refusal to purchase the departing member's ownership interest. If neither the group nor individual members exercised the right of first refusal, the departing member (or his legal representative) could continue to hold the ownership interest so long as ownership did not violate laws and regulations governing medical practices. In that situation, the member had the right to demand redemption by the medical group. The appellants alternatively contended that the medical group in fact exercised its right of first refusal, pointing to testimony of TENT's bookkeeper that Jones was given a \$10 credit in TENT's books for his "stock" in January 2010. In support of the jury's finding, Jones cited numerous external communications after January 2010 in which TENT continued to represent that he was a member, including TENT's tax returns and his own K-1s from TENT, emails stating that Jones should be invited to board meetings, and a letter from TENT to its bank listing Jones as a "remaining partner." Thus, there was evidence to support the jury's finding that Jones was still a member at the time of trial.

The appellants next challenged the award of attorney's fees to Jones for denial of access to TENT's books and records, the only relief sought or awarded for this cause of action at trial. The trial court based the award on the jury's finding as well as Tex. Bus. Orgs. Code §§ 3.151 et seq. & 101.501 et seq. The individual physicians and not TENT as an entity were ordered to pay the attorney's fees. Jones made his first written request for access on November 18, 2009, but he made subsequent requests as well. The appellants raised numerous sub-issues regarding the award of attorney's fees, including that (1) Jones failed to state a proper purpose for requesting access; (2) applicable law did not provide for the recovery; (3) Jones was not a "governing person" entitled to recovery; (4) the court erred in its jury submission on the issue; (5) the evidence was insufficient to support the finding that Jones was denied access; (6) if denial occurred, it was only after his membership was terminated; (7) the court erred in ordering the individual defendants, rather than TENT, to pay the fees; and (8) Jones failed to properly segregate his attorney's fees. The court of appeals concluded that Jones was entitled to recover attorney's fees against TENT but not the individual defendants and that Jones failed to segregate his attorney's fees properly.

The appellants first two arguments—that Jones failed to state a proper purpose for requesting access and that applicable law did not provide for the recovery of attorney's fees—were both based on the proposition that Jones's rights regarding access were governed by the Texas Limited Liability Company Act (TLLCA) and not the Business Organizations Code (BOC). The TLLCA provided that a member had the right, on written request stating the purpose, to examine and copy for any proper purpose records required to be kept under that statute and other information. Tex. Rev. Civ. Stat. art. 1528n § 2.22.D (expired). The BOC provides at Tex. Bus. Orgs. Code § 101.502(a) that "[a] member ... on written request and for a proper purpose, may examine and copy" the required records, and the BOC additionally provides that a "governing person ... may examine the entity's books and records ... for a purpose reasonably related to the governing person's service as a governing person." *Id.* § 3.152(a). The BOC further authorizes an award of attorney's fees as a remedy for denial of access as to a request by a governing person. *Id.* § 3.152(c). The appellants argued that the TLLCA rather than the BOC governed this case because Jones made his first request for access on November 18, 2009, prior to the expiration of the TLLCA and the BOC's mandatory application date of January 1, 2010. On that basis, the appellants argued that the trial court erred because Jones's written request did not state a purpose, as required by the TLLCA but not the BOC, and attorney's fees were not an available remedy under the TLLCA. The transition provisions of the BOC provide that the BOC governs "acts, contracts, or other transactions by an entity subject to this code or its managerial officials, owners, or members that occur on or after the mandatory application date." *Id.* § 402.006. Prior law (i.e., the TLLCA in this

case) continues to govern acts, contracts, and transactions that occurred before the mandatory application date. Although Jones made his first written request for access on November 18, 2009, the record made clear that he continued to make requests for information after the mandatory application date and never received access to all of the information sought. Thus, the trial court did not err in holding that the BOC governed.

The appellants also argued that Jones was not a “governing person” entitled to recover attorney's fees under the BOC. (Tex. Bus. Orgs. Code § 3.152(c) provides that “[a] court may award a governing person attorney's fees and any other proper relief in a suit to require a filing entity to open its books and records....”). The appellants relied solely on a statement in Jones’s third amended petition in which Jones referred to his right to examine books and records under Sections 3.151 et seq. and 101.501 et seq. after his retirement because he remained a member. The appellants contended that Jones admitted in this assertion that he was not a governing person. The court of appeals found nothing in this assertion that addressed whether Jones was a governing person and concluded that the appellants had waived this pleading deficiency argument in any event.

Next, the appellants complained of the trial court's refusal to submit their tendered instruction to the question on denial of access. The requested instruction read as follows: “You are instructed that John Jones was entitled to access to TENT's books and records for a ‘proper purpose.’ You are instructed that demands for records to harass TENT, force TENT to purchase Jones' interest at an inflated price, or made in bad faith, are not ‘proper purposes.’” Based on the trial court’s discretion in determining necessary and proper jury instructions, the court of appeals concluded the trial court did not err. Explanatory instructions should be submitted when, in the discretion of the trial court, the instructions will help jurors understand the meaning and effect of the law and the presumptions the law creates. When a trial court refuses to submit a requested instruction, the ultimate question on appeal is whether the instruction was reasonably necessary to enable the jury to render a proper verdict. The appellants derived the language in their proposed instruction from *In re Dyer Custom Installation, Inc.*, 133 S.W.3d 878, 881–82 (Tex. App.—Dallas 2004, orig. proceeding). In that case, the court listed allegations that had been found sufficient to entitle a corporation to a jury trial on the issue of whether a shareholder had a proper purpose in requesting access under article 2.44 of the Texas Business Corporation Act, which provided similar access to that provided by the BOC provisions at issue here. Assuming the *In re Dyer* analysis was applicable in this case, the court said that not every correct statement of the law belongs in the charge. The trial court here reasonably could have determined that the requested instruction was unnecessary for the jury's understanding of the issue and that it only served to emphasize the appellants' position.

The court next reviewed the evidence to determine if it was sufficient to support the jury’s finding that Jones was denied access to TENT's records. The court concluded that the appellants did not properly brief this argument, which hinged on their assertion that the company was not required to keep all the information Jones requested. Accordingly, the court found no merit in the appellants' sufficiency assertions.

The appellants’ argument that TENT was not required to furnish information to Jones because he was no longer a member failed because the court of appeals previously concluded that the evidence supported the jury’s finding that Jones was still a member of TENT at the time of trial. He was thus a member when he requested access to TENT's books and records.

The appellants next argued that the trial court erred in ordering the individual defendants to pay Jones's attorney's fees instead of TENT. Section 3.152 of the BOC provides that a court may order an entity to open its books and records if the entity has improperly refused access, and the court may award attorney's fees and other proper relief “in a suit to require a filing entity to open its books and records.” Tex. Bus. Orgs. Code § 3.152(b), (c). To be entitled to this relief, the requesting person must establish, among other things, that “the entity refused the person's good faith demand to inspect the books and records.” *Id.* § 3.152(b). The court stated that the focus of the provision is on the actions of the entity, and the provision does not suggest that any individual connected with an entity can be ordered to open the books and records or to pay attorney's fees. Jones noted that the jury specifically found that the individual defendants acted in concert to deny Jones's access, and Jones argued that awarding fees against TENT would punish TENT for the actions of its members. Jones also suggested that the award of fees could jeopardize the possible sale of TENT. But the court of appeals stated that the fees were awarded pursuant to Section 3.152(c), not based on shareholder oppression by the individual defendants, and the fact that the individual defendants may have caused the denial of access and that TENT might be affected by the award did not change the statutory language. The court of appeals thus concluded that the trial court should have ordered TENT and not the individual defendants to pay Jones's attorney's fees, and that the judgment should be modified to order TENT to pay the fees instead of the individual defendants.

The final issue addressed by the court of appeals regarding the denial of access claim was the appellants' contention that Jones failed to properly segregate the portion of his attorney's fees related to this claim from the fees related to other claims. The court of appeals agreed and remanded this issue for further consideration by the trial court.

The court of appeals then turned to Jones's oppression claims. The appellants challenged the jury's findings in favor of Jones on his "shareholder oppression" claims as well as the trial court's buyout order requiring the appellants to pay Jones \$277,500 for his interest in TENT. After the trial of the case and the original round of briefing on appeal, the Texas Supreme Court held in *Ritchie v. Rupe*, 443 S.W.3d 877 (Tex. 2014), that there is no common-law cause of action for shareholder oppression and that the only available remedy under the shareholder oppression statute is the appointment of a rehabilitative receiver. The court of appeals referred to this opinion as a "sea change in the realm of shareholder oppression law." Based on *Ritchie*, the trial court's buyout order could not stand. Additionally, the court of appeals had to determine whether to render judgment on Jones's oppression claim or remand for additional proceedings. In *Ritchie*, the supreme court explained that ordinarily it would consider remanding for a new trial when it announced a new legal standard, but in the case before it, remand of the shareholder oppression claims was not necessary because the plaintiff had sought only a buyout and had not requested the appointment of a rehabilitative receiver as alternate relief. Here, however, Jones did plead for appointment of a receiver under Section 11.404 of the BOC as one of the possible remedies. The appellants nevertheless urged that remand for consideration of other relief was not necessary in this case because the evidence presented at trial was legally insufficient to support the jury's findings and the trial court's judgment. The court of appeals said that the difficulty with this argument was that Jones prepared his case and presented his evidence without the benefit of knowing that the standard for proving shareholder oppression would change after the verdict. For example, the court said that Jones may have perceived no need to present evidence as to whether the appellants' actions were justified under the business judgment rule, which typically was not applied in shareholder oppression cases prior to *Ritchie*. Thus, the court of appeals reversed the trial court's buyout order, but, in the interest of justice, remanded Jones's shareholder oppression claims for further proceedings in keeping with recent supreme court precedent.

## **J. Dissolution/Winding Up**

*Hill v. Hill*, 2015 WL 1404650, \_\_ S.W.3d \_\_ (Tex. App.–Dallas 2015, pet. filed).

After previous litigation between the father and son owners of an LLC, the father filed a lawsuit to wind up and terminate the LLC. About a year later, after several discovery disputes, the trial court granted the father summary judgment and ordered the receiver to wind up and terminate the LLC and distribute any remaining assets to the son after payment of court-ordered receiver fees. The son appealed the summary judgment on the basis that there was a fact issue as to whether the receiver properly calculated the capital accounts in the final report in the first lawsuit, and the son argued in a petition for mandamus that the trial court's orders granting the receiver's post-judgment fee applications were void. The court of appeals rejected all of the son's arguments and affirmed the summary judgment.

In the first lawsuit between the father and son, a receiver was appointed for their jointly owned LLC, and the parties eventually entered into a global settlement agreement. The son paid to the receiver the amount he owed the LLC, the court granted the father's application requesting that the receiver pay the LLC's liabilities and court-approved receiver's fees and distribute to the father 50% of the remaining funds. The court then dismissed with prejudice all claims that were raised or could have been raised in that lawsuit, but the court's order provided that it did not preclude either of the members from filing a lawsuit to wind up and terminate the business of the LLC under Section 11.314 of the Business Organizations Code.

The father filed this action to wind up and terminate the LLC on the basis that the LLC could no longer operate because it was hopelessly deadlocked and the receiver had completed his work except for filing tax returns and terminating and winding up the LLC. The son answered and requested access to the LLC's books and records and an accounting. Over the next year, the parties engaged in discovery and presented several discovery disputes to the trial court. The son and the receiver filed a joint motion for summary judgment dissolving the LLC, and the trial court granted the motion. The trial court found it was not reasonably practicable to carry on the business of the LLC in conformity with its governing documents and ordered the receiver to wind up and terminate the LLC. The receiver was ordered to distribute to the son any assets remaining after payment of court-ordered receiver fees

up to the amount previously distributed to the father in the first lawsuit. After that distribution, any remaining assets of the LLC were to be split equally between the father and son. The receiver was also instructed to file a final fee application. The trial court signed a final judgment finding the receiver had completed winding up and terminating the LLC, distributed the remaining assets of the LLC as ordered, and filed a certificate of termination with the secretary of state. The judgment recited that the receiver filed a final fee application, which had been granted. The trial court also released the receiver from all duties other than payment of fees approved under the final fee application, filing of final tax returns, and distributing the books and records of the LLC pursuant to the order. The son appealed.

On appeal, the son argued that the summary judgment evidence raised a genuine issue of material fact as to whether the receiver correctly calculated the members' capital accounts in the final report filed in the first lawsuit. The final report recited that the father had 52% of the total member capital and the son had 48% although the court stated that it was undisputed that the two men were "equal shareholders." The 2008 balance sheet attached to the receiver's final report showed the son with 52% and the father with 48% of the total member capital. The 2010 balance sheet showed the son with 48% and the father with 52% of the total member capital. The son relied on an accounting expert who made various observations about the LLC's accounting records, and the son argued that the expert's affidavit raised a genuine issue of material fact about the receiver's calculation of the capital accounts. However, the expert merely noted he was unable to verify all of the LLC's accounting records. The fact that the expert could not verify the capital accounts from records provided to him did not raise a genuine issue of material fact, but merely supported speculation about whether the capital accounts were accurate or not. In addition, the expert's speculations about the calculation of the capital accounts were not material to the distribution of the remaining assets of the LLC under the facts of the case. It was undisputed that the receiver collected all of the assets of the LLC and paid all of its obligations in the first lawsuit. In that proceeding, the trial court ordered half of the remaining assets distributed to the father. That order in the first lawsuit merged into the final judgment in that case and became final and thus was not subject to a collateral attack in this proceeding.

The court of appeals disagreed with the son's argument that calculation of the capital accounts affected the ultimate outcome of this case and was part of the accounting required by the winding-up process. The summary judgment order in this case ordered that the son receive all of the remaining assets of the LLC after payment of the receiver's fees and expenses up to the amount distributed to the father in the first lawsuit. The son contended that if the receiver credited the son's capital account with certain amounts identified by the expert, the corrections "could have resulted in a credit balance in [the son's] capital account that exceeded [the father's], and that potentially would have been distributable upon winding up of the Company." Under the trial court's final judgment, however, the son was already receiving all of the remaining assets of the LLC up to the amount previously distributed to the father, and there was no evidence in the record that the LLC had enough assets to distribute even that amount. The receiver's final prejudgment fee application indicated that all of the remaining assets in the LLC had been exhausted to pay the expenses of the receivership. Thus, the summary judgment evidence did not contain any opinion or evidence material to the issue before the trial court, i.e., whether the father and the receiver were entitled to an order for the winding up and termination of the LLC under Section 11.314 of the Business Organizations Code.

The son also argued in his petition for writ of mandamus that orders of the trial court granting post-judgment fee applications by the receiver were void because they were issued after the trial court lost plenary power over the final judgment. The court of appeals discussed this issue at length and concluded that the trial court had jurisdiction under the record in this case to continue the receivership and to authorize the receiver to continue to participate in the case while the final judgment was on appeal. Therefore, the post-judgment fee applications at issue were not void.

Finally, the court of appeals rejected the son's argument that the trial court had no legal basis to assess all of the receiver's post-judgment fees against him and that doing so amounted to an impermissible sanction. Receiver's fees are considered court costs and are governed by rules regarding the award of costs. Taxation of costs of a receivership and the manner of their collection are matters within the discretion of the trial court. The trial court chose to follow Rule 131, under which the successful party in a suit shall recover from the other party all costs incurred in the suit. The son was not the successful party in the litigation because he opposed the granting of summary judgment and lost. Thus, the trial court did not abuse its discretion by assessing all of the receiver's post-judgment fees against him.

## K. Withdrawal or Expulsion of Member

*Cantu v. Frye & Associates, PLLC*, No. 01-12-00868-CV, 2014 WL 2626439 (Tex. App.–Houston [1<sup>st</sup> Dist.] June 12, 2014, no pet.) (mem. op.).

After a professional limited liability company (law firm) expelled a member based on an expulsion provision in the company agreement, the expelled member sued the firm and the remaining members for various claims in connection with her expulsion as well as fraud in connection with her purchase of an interest in the firm. The court of appeals upheld the trial court's grant of the defendants' summary judgment motions. The court of appeals concluded that the summary-judgment evidence conclusively established that the defendants' actions in expelling the member and forfeiting her interest were not unlawful and that summary-judgment evidence suggesting that the firm did not follow through on statements made at the time of the member's purchase of her interest in the firm did not constitute fraud because there was no evidence that the promises were made without the intent to perform at the time and the company agreement contained a merger clause so that the oral statements before the purchase were of no legal effect.

Patricia Cantu joined the law firm of Simoneaux and Frye, PLLC as an associate attorney. The only two owners of the firm at that time were Frye and Simoneaux. Cantu later bought part of Simoneaux's interest when he decided to leave the firm. Another lawyer, Benavidez, also bought part of Simoneaux's interest. Cantu and Benavidez were admitted as members, and the ownership of the firm was as follows: Frye 60%, Cantu 30%, and Benavidez 10%. The firm's name was changed to Frye & Cantu, PLLC, and Frye was the sole manager. The firm's company agreement provided the firm with certain remedies for a member's default, including "Forfeiture of the Defaulting Member's Membership Interest," and it contained a procedure for expulsion of a member for cause:

15.04 Expulsion. A Member may be expelled from the Company by unanimous vote of all other Members (not including the Member to be expelled) if that Member (a) has willfully violated any provision of this Agreement; (b) committed fraud, theft, or gross negligence against the Company or one or more Members of the Company; or (c) engaged in wrongful conduct that adversely and materially affects the business or operation of the Company. Such a Member shall be considered a Defaulting Member, and the Company or other Members may also exercise any one or more of the remedies provided for in Article 15.01. The Company may offset any damages to the Company or its Members occasioned by the misconduct of the expelled member against any amounts distributable or otherwise payable by the Company to the expelled Member.

Over the course of the year following Cantu's purchase of an ownership interest in the firm, she used the law firm's debit card for numerous personal expenses exceeding \$8,000. In her deposition, Cantu admitted that she had never discussed the personal use of the firm debit card with Frye or the office manager. She testified that the law firm had no policy prohibiting the use of the firm's debit card for personal expenses, "just so long as it was repaid ... on payday." In addition, Cantu's clients were not paying their bills, which Cantu claimed resulted from the office manager's failure to cooperate in pursuing payment. Cantu claimed that she was unable to repay the amounts she owed for use of the firm's debit card on payday because her pay decreased when collections on her client's accounts receivable were not paid.

When Frye learned that Cantu was using the firm's debit card for personal expenses and that there was a large amount of uncollected fees owed by Cantu's clients, Frye demanded that Cantu resign. Cantu did not resign, and the firm held a meeting at which Frye and Benavidez voted to expel her pursuant to the company agreement. The minutes reflected that Cantu was "expelled" from the firm and that she had "zero membership interest." Cantu repaid the money owed and filed suit against Frye & Associates, PLLC (the successor to Frye and Cantu, PLLC), and Frye and Benavidez individually. Cantu alleged causes of action for: (1) civil theft; (2) statutory and common-law fraud, in connection with her purchase of "stock" in the firm; (3) common-law fraud, in connection with her expulsion from the firm; and (4) conspiracy and aiding and abetting, in connection with her expulsion from the firm. The defendants filed three different motions for summary judgment, and the trial court ruled in favor of the defendants. Cantu appealed, and the court of appeals addressed the arguments and evidence on a claim-by-claim basis to determine if the trial court's grant of summary judgment was properly based on any expressed ground as to each cause of action.

With respect to Cantu's conversion and theft claims, the court of appeals noted that both causes of action require an unlawful taking of a property interest. Cantu argued that the defendants acted improperly in expelling her from the firm and forfeiting her interest because there was a lack of proof that she committed fraud, theft, or gross negligence, as provided in the expulsion clause of the company agreement. In the absence of a definition of "theft" in the company agreement, the court looked to the Texas Penal Code, which defines theft as the unlawful appropriation of property with intent to deprive the owner of it. The defendants' summary-judgment evidence showed that Cantu appropriated company funds by using the debit card for personal expenses; that she did so without consent of the company, a manager of the company, a majority of the members, or in accordance with the distribution provisions in the company agreement; and that she actually deprived the company of the money, which is evidence of intent. The evidence showed that the two other members of the company, Frye and Benavidez, voted to expel her, in conformity with the company agreement. Finally, the company agreement provided a choice of remedies, which included forfeiture for the default of a member under Section 15.01(g). Cantu argued that she did not need permission to use the debit card as a 30% member of the company, that the minutes of the meeting at which she was expelled erroneously identified it as a regular meeting rather than a special meeting, and that Section 15.01(g) did not apply because it addressed a member's failure to make a capital contribution. According to the court of appeals, Cantu's summary-judgment evidence offered her differing interpretation of the company agreement but no evidence that actually contradicted the defendants' summary-judgment evidence. To the contrary, the court concluded that the summary-judgment evidence conclusively showed that the defendants' actions in expelling Cantu and forfeiting her interest were not unlawful. The expulsion provision of the company agreement incorporated the remedies of Section 15.01 of the agreement by reference. Cantu's affidavit was consistent with the defendants' summary-judgment evidence that they held a meeting, confronted her with the allegations of theft and gross negligence, voted "unanimously" (as defined in the company agreement) to expel her, and forfeited her ownership interest as provided for in Section 15.01(g).

In connection with her common-law and statutory fraud claims, Cantu averred that Frye made representations on which Cantu relied when she purchased her ownership interest in the firm. Cantu stated that Frye represented that Cantu's ownership interest entitled her to the full benefits of the company's resources and the full complement of administrative staff but that the office manager and Frye refused to provide Cantu support for her collection efforts. While the summary-judgment evidence suggested that Frye did not follow through on representations made to Cantu, the court said this was not evidence that the representations were false when made because there was no evidence that these promises were made with the intent not to perform. Additionally, the company agreement contained a merger clause stating that the agreement "includes the entire agreement of the Members and their Affiliates relating to the Company and supersedes all prior contracts or agreements with respect to the Company, whether oral or written." In light of this provision, the court stated that the oral representations made before Cantu's purchase of Simoneaux's interest had no legal effect, and her affidavit constituted no evidence of an actionable misrepresentation.

Finally, as to Cantu's conspiracy and aiding and abetting claims, the court of appeals agreed with the defendants that there was no evidence of any underlying tort to which these claims would apply. Cantu's conspiracy claims were based entirely on actions taken in connection with her expulsion from the firm, and the court previously held that the defendants proved as a matter of law that the expulsion was properly accomplished.

See also *Texas Ear Nose & Throat Consultants, PLLC v. Jones*, 2015 WL 3918130, \_\_ S.W.3d \_\_ (Tex. App. Houston [14<sup>th</sup> Dist.] June 25, 2015, no pet. h.), summarized below under the heading "Record Keeping Requirements and Access to Books and Records."

#### **L. Veil Piercing**

*Copeland v. D & J Construction LLC*, No. 3:13-CV-4432-N-BH, 2015 WL 512590 (N.D. Tex. Feb. 6, 2015).

The individual defendants in this case contended that they should be dismissed because all of the plaintiff's claims related to the defendant LLC, and the individuals argued they were protected from liability under Sections 101.113 and 101.114 of the Texas Business Organizations Code (BOC). The court held that the pleadings were sufficient as to one individual defendant to support a claim of liability for breach of the LLC's contract based on veil piercing, but the pleadings were not sufficient as to the other defendants. The pleadings were sufficient to



support tort claims against the individual defendants based on the alleged wrongful conduct of the individual defendants themselves.

The plaintiff filed a suit against D & J Construction, LLC, Johnny Gray III, Darrell Gray, and Ethel Yolanda Gray, alleging claims for breach of contract and tort claims that included slander, libel, intentional infliction of emotional distress, and intentional interference with prospective economic advantage. The individual defendants contended that as members and managers of a Texas LLC, they could not be held liable for the LLC's debts, obligations, or liabilities based on Tex. Bus. Orgs. Code §§ 101.113, 101.114. In response, the plaintiff alleged that the individual defendants could be held liable under the "corporate veil doctrine" because the LLC was the alter ego of one of the individual defendants, and the defendants were operating a sham and committing fraud upon the public. The court stated that, in Texas, the corporate veil may be pierced where "(1) the [LLC] is the alter ego of its owners and/or shareholders; (2) the [LLC] is used for illegal purposes; and (3) the [LLC] is used as a sham to perpetrate a fraud." The court explained that the traditional alter-ego doctrine was changed substantially by the codification of the doctrine in Section 21.223 of the BOC, which requires a showing that a shareholder or affiliate used the corporation to perpetrate an actual fraud for the direct personal benefit of the shareholder or affiliate in order to hold a shareholder liable for a contractual obligation of the corporation. The court noted that Texas courts have applied the statutory provisions on corporate veil piercing to LLCs.

The court held that the plaintiff's pleadings, liberally construed, sufficiently alleged facts to support a finding of actual fraud for purposes of piercing the corporate veil. The standard for actual fraud is "dishonesty of purpose or intent to deceive." Additionally, the actual fraud must relate specifically to the contract at issue. The plaintiff asserted generally that *all* of the individual defendants' business model was to receive payment for work done but refuse to pay the workers who actually did the work. Because the plaintiff also alleged that the individual defendants agreed to hire the plaintiff for specific tasks on behalf of the LLC and then refused to pay him, the court concluded that he pled sufficient facts showing that the individual defendants had the intent to deceive him, showing actual fraud.

The plaintiff also sufficiently alleged that Johnny Gray III reaped personal benefit by alleging that Johnny Gray III was the sole member of the LLC defendant and used the debit cards of the business for his personal expenses. Additionally, the plaintiff alleged that Johnny Gray III perpetrated fraud by hiring workers and refusing to pay them once the work was completed. The plaintiff also contended that, Johnny Gray III, as the sole member of the LLC, did not obtain the required liability insurance for the LLC and that the lack of formality was additional evidence that the LLC was a mere front for Johnny Gray III to perpetuate fraud. Liberally construing the plaintiff's assertions as required under a Rule 12(b)(6) analysis, the plaintiff sufficiently alleged actual fraud and that Johnny Gray III used the LLC to perpetrate the fraud to allow piercing the LLC's corporate veil.

The plaintiff did not, however, provide facts showing that Darrell Gray and Ethel Yolanda Gray perpetrated the fraud for direct benefit to themselves. The plaintiff did not allege that Darrell Gray or Ethel Yolanda Gray used the LLC's resources for personal gain, or that they were members of the LLC. The plaintiff conceded that the sole member of the LLC was Johnny Gray III. The plaintiff alleged generally that the individual defendants filed with different cities and municipalities three separate business entities at the same address without proper liability insurance for the purpose of evading suits, judgments, garnishments, and liens, and that the defendants were committing fraud upon the public, but the plaintiff did not allege any facts showing that the LLC was an alter ego of Darrell Gray or Ethel Yolanda Gray.

The plaintiff alleged various tort claims against the defendants based on allegations that the individual defendants made defamatory statements about him during telephone calls and in text messages. The court stated the principle that an agent of an LLC is personally liable for his own fraudulent or tortious acts, even when acting within the course and scope of his employment, relying on case law addressing liability of corporate officers and employees for the wrongdoing of the officers or employees, even when acting in their representative capacities. The court further stated that the BOC supports distinguishing tort suits from contract suits when finding personal liability of a corporate officer, stating that Sections 101.114 and 21.223 "support the conclusion that, in cases of misrepresentation or fraud (as opposed to simple breach of contract), a corporate agent may be held personally liable for his own misrepresentations." The plaintiff's pleadings described allegedly false and defamatory statements in phone calls and text messages to the district attorney and vendors. The court characterized the alleged statements made as "intentional tortious acts akin to 'fraudulent statements or knowing misrepresentations'" that lead to individual liability. Thus, the court held that the plaintiff sufficiently pled specific tortious actions by the individual defendants that could subject them to personal liability.

*In re Packer*, 520 B.R. 520 (Bankr. E.D. Tex. 2014).

A judgment creditor of Packer sought to reach the assets of several LLCs and other entities in which Packer owned most or all of the membership interests. The court rejected this reverse veil-piercing claim because alter-ego claims, including reverse veil-piercing actions, are property of the bankruptcy estate, and the plaintiff thus lacked standing to pursue such claims. Additionally, the court rejected the plaintiff's claim that Packer should have listed the assets of his entities in his personal bankruptcy schedules. The plaintiff in essence relied on reverse veil-piercing principles as the basis for denying Packer's discharge under Section 727(a) of the Bankruptcy Code, and the court concluded that the plaintiff did not establish that the provisions relied upon by the plaintiff had been satisfied.

The plaintiff sought to reach the assets of LLCs owned by Packer to satisfy a judgment against Packer held by the plaintiff, contending that Packer improperly disregarded corporate formalities with regard to the companies and utilized them to hinder, delay, and defraud his individual creditors. The court stated that this count was essentially a claim for reverse veil piercing. The court disregarded the evidence of Packer's failure to observe corporate formalities or otherwise maintain a separate identity from the companies and dismissed this count because it is well-established in the Fifth Circuit that alter-ego claims and reverse veil-piercing actions are property of the bankruptcy estate and lie within the exclusive control of the trustee.

In the course of the court's rejection of the plaintiff's reverse veil-piercing count, the court in a footnote explained that the application of veil-piercing principles, and particularly those of *reverse* veil piercing, is problematic when dealing with an individual's role in an LLC, particularly a single-member LLC. The court stated that the disregard of corporation formalities should not imperil the liability protection of an LLC in a small LLC that is managed by one or a few members who will not necessarily follow meaningless formalities such as formal meetings. The court pointed out that the Texas legislature in Section 101.002 of the Business Organizations Code has subjected veil-piercing principles in an LLC context to the same limitations already imposed as to corporations under Section 21.223 of the Business Organizations Code, including the general concept that the corporate veil may not be pierced in Texas based on failure to follow corporate formalities. The court described the Texas statutes as generally allowing veil piercing only upon proof of actual fraud for the direct personal benefit of a shareholder based upon a showing of dishonesty of purpose or an intent to deceive. As to LLCs, the court went on to state: "Similarly, as a relatively new creature under state law, an LLC is purposefully designed to provide the limited personal liability afforded under corporate law while providing the pass-through taxation benefits of a partnership. [citation omitted] Therefore, the singular fact that the owner of a single-member LLC may elect through the IRS' check-the-box regulations for the LLC to be disregarded as a separate taxable entity for the purposes of federal income taxation, see 26 C.F.R. 301.7701-1 (2011), should have no bearing on the veil-piercing analysis."

The plaintiff also sought denial of Packer's discharge under various subsections of Section 727(a) of the Bankruptcy Code based on Packer's failure to list assets of his companies on his personal bankruptcy schedules. This argument essentially relied on alter-ego/veil-piercing arguments, especially Packer's continued use of the bank account of one of his single-member LLCs, from which he paid personal expenses. The plaintiff sought to use reverse-piercing principles to deny Packer's discharge under Section 727(a) although the plaintiff was precluded under federal bankruptcy law (because a veil-piercing claim belonged to the bankruptcy estate) and Texas law (because the entities were not joined as parties) from obtaining a judgment against the entities. The plaintiff argued that Packer should be punished through denial of his discharge for his failure to admit and acknowledge personal ownership of corporate and LLC assets. Although the plaintiff was barred from pleading and proving any type of alter-ego claim, the plaintiff urged the court to use its equitable powers to apply the reverse veil-piercing principles to reach a just result, even though those principles could not actually be used to disregard the legal protections that the LLCs and other entities had under applicable Texas law. The court stated that equitable principles could not be legitimately used to sidestep the clear requirements of the Bankruptcy Code and to ignore the protections of state law in order to establish an artificial evidentiary foundation upon which to deny Packer's discharge. In light of the plaintiff's lack of standing to bring its reverse veil-piercing claims, and the fact that the organizational integrity of Packer's entities would not be compromised as a result of this adversary proceeding, the court stated that it must disregard any summary judgment evidence submitted by the plaintiff to establish that the assets of any independent company should be treated as the assets of the bankruptcy estate or that Packer could be sanctioned for his failure to schedule those corporate assets as his own. There was simply no legal basis upon which Packer was required to list or account for the assets of his separate entities in his personal bankruptcy schedules.

The court also concluded that Packer's involvement with his LLCs and other entities did not present an issue for trial on the Section 727(a) claims. The summary judgment record established that Packer did not conceal material information regarding the conduct of his financial affairs within the requisite time period. He disclosed the existence of his various companies and his use of one LLC's assets to pay personal expenses. Recognizing that single-member LLCs and closely-held corporations can only engage in business activity through the actions of involved individuals, Packer described his interactions with his entities, particularly the LLC that paid his personal expenses, to the trustee at the Section 341 meeting and answered all questions he was asked regarding the activities of that LLC. Nothing in the record indicated that the trustee was dissatisfied with the responses to those inquiries. Packer's claim that his membership interests in his companies had no value could not be characterized as meritless, and there was no indication that Packer was not cooperative with the trustee throughout the bankruptcy process. The trustee had ample opportunity to examine Packer regarding his entities and to take appropriate action against the entities for the benefit of the bankruptcy estate if the trustee thought that Packer was improperly utilizing them for fraudulent or dishonest purposes. No summary judgment evidence indicated that the trustee was dissatisfied with Packer's level of disclosure and cooperation. While a discharge may be properly denied for concealment when a debtor places assets beyond the legitimate reach of creditors or withholds vital information to which creditors are entitled, that did not occur in this case. Here there was disclosure and the opportunity for the bankruptcy estate to take appropriate action as advisable. That is the *quid pro quo* for a bankruptcy discharge.

There were some aspects of this dispute that troubled the court. Although Packer had the right to disregard his wholly owned LLC as a separate taxable entity for federal income tax purposes, he had no right to disregard its organizational integrity. Once Packer was owed money by his LLC for personal services, Packer was not permitted to unilaterally retain such funds in the LLC account to frustrate the collection rights of a creditor. However, because the structural integrity of the LLC was not legally compromised and in light of the summary judgment evidence that the LLC's contracts produced LLC assets in its account, the plaintiff was required to provide specific evidence that Packer had improperly retained *his* funds in the LLC account during the requisite time period. By failing to present such summary judgment evidence, there was nothing in the record contradicting the legal conclusion that the funds in the LLC account constituted LLC assets. If the appropriation of LLC assets by Packer was improper, as the plaintiff alleged, it was improper as to (and perhaps avoidable by) LLC creditors, but not to creditors of Packer. With the "corporate veil" of the LLC intact, the plaintiff's unsubstantiated assertions and speculation regarding the impropriety of Packer's use of the LLC funds were not sufficient to defeat Packer's motion for summary judgment.

#### **M. Creditor's Remedies: Charging Order**

*In re Prodigy Services LLC*, No. 14-14-00248-CV, 2014 WL 2936928 (Tex. App.-Houston [14<sup>th</sup> Dist.] June 26, 2014, no pet.) (mem. op.).

In this mandamus action, the court of appeals held that the trial court erred in refusing to disburse to an LLC the proceeds of a settlement that were held in the trial court's registry. The Office of the Attorney General ("OAG") appeared in the case and sought to reach the settlement proceeds to satisfy child support obligations of the member of the LLC. As the judgment creditor of the member, the OAG's only remedy with respect to the LLC was a charging order. The LLC was entitled to receive the proceeds of its settlement in the lawsuit, and the OAG would have to await distribution of the settlement proceeds from the LLC to reach them.

An LLC settled a lawsuit it had brought, and the defendant paid the settlement proceeds into the registry of the trial court. The OAG, which had a lien against the LLC's member for unpaid child support, appeared in the case and argued that the court should pay the settlement proceeds to the OAG. The OAG also requested a charging order. The LLC moved to disburse the settlement funds from the registry of the court. The trial court denied the LLC's motion to disburse. After additional motions and hearings, a hearing was set on the OAG's request for a charging order and/or motion to disburse. The LLC filed its petition for writ of mandamus seeking, among other relief, disbursement of the settlement proceeds to the LLC.

The court of appeals began its analysis of the OAG's rights by reviewing the parameters of a charging order. The court explained that the charging order is the method by which a judgment creditor of an LLC member or assignee reaches the membership interest. A judgment creditor of a member may apply to the trial court having jurisdiction to "charge the membership interest of the judgment debtor to satisfy the judgment." Tex. Bus. Orgs. Code § 101.112(a). The member does not have an interest in any specific property of the company. Tex. Bus. Orgs.

Code § 101.106(b). Thus, a charging order only provides the member's judgment creditor the right to receive any distribution that the member would be entitled to receive with respect to the membership interest. Tex. Bus. Orgs. Code § 101.112(b). The charging order is a lien on the membership interest of the judgment debtor, but the judgment creditor may not foreclose on it. *Id.* § 101.112(c). In addition, the judgment creditor of the member has no right to possess or exercise legal or equitable remedies with respect to the LLC's property. *Id.* § 101.112(f). The court discussed *Stanley v. Reef Securities, Inc.*, 314 S.W.3d 659 (Tex. App.—Dallas 2010, no pet.), a case in which the charging order remedy was analyzed in the partnership context. The court of appeals in *Stanley* concluded that the charging order provisions do not preclude a judgment creditor from seeking the turnover of proceeds from a partnership distribution after that distribution has been made and is in the debtor partner's possession.

The narrow issues to be decided by the court of appeals in this proceeding were whether the trial court abused its discretion by denying the LLC's motion to disburse the settlement fund, and whether the LLC had an adequate remedy by appeal. The court stated that the OAG, although recognizing that Texas law does not permit a judgment creditor to foreclose on the lien created by a charging order, was skipping the necessary first step. Before any proceeds could be distributed to the LLC member, the settlement proceeds must be disbursed to the LLC. As the member's judgment creditor, the OAG "does not have the right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited liability company." Tex. Bus. Orgs. Code § 101.112(f). Thus, the trial court could not force the LLC to make distributions to the member, and the OAG must wait for the LLC to make such distributions before it can attempt to satisfy the child support judgment against the member.

The court concluded that Texas law makes clear that the OAG had no entitlement to the settlement funds deposited into the registry of the court, and there was no reason for the trial court to refrain from ordering the settlement funds disbursed to the LLC. If the trial court were to order the disbursement of the settlement proceeds directly to the OAG from the registry of the court, the LLC may not be able to recover the funds once they are disbursed to the OAG. Therefore, the court concluded that the LLC did not have an adequate remedy by appeal, and the court conditionally granted the writ of mandamus, which would issue if the trial court did not vacate its order denying the LLC's motion to disburse and disburse the settlement proceeds in accordance with the court's opinion.

See also *In re Wilson*, No. 11-50396-rlj-7, 2014 WL 3700634 (Bankr. N.D. Tex. July 24, 2014), summarized below under the heading "Bankruptcy."

#### **N. Recovery of Attorney's Fees**

See *Hoffman v. L & M Arts*, Civil Action No. 3:10-CV-0953-D, 2015 WL 1000838 (N.D. Tex. Mar. 6, 2015), summarized above under the heading "Nature of Limited Liability Company."

#### **O. Arbitration**

*In re Galaz (Galaz v. Galaz)*, 765 F.3d 426 (5<sup>th</sup> Cir. 2014).

Lisa Galaz brought an adversary proceeding against her ex-husband, Raul Galaz, for fraudulently transferring the assets of an LLC in which Lisa owned a 25% economic interest. In Lisa and Raul's divorce, they executed a divorce decree under which Raul assigned half of his LLC 50% interest to Lisa. The transfer occurred in violation of the operating agreement without the other member's consent, and Lisa therefore received a 25% economic interest with no management or voting rights. Raul, as manager of the LLC, transferred the assets of the LLC to another entity that he formed with his father. The bankruptcy court found that the transfer was invalid under the Texas Uniform Fraudulent Transfer Act and awarded Lisa a judgment for damages against the defendants. One of the contentions in this appeal by Raul and the transferee entity was that the bankruptcy court should have referred Lisa's claims to arbitration pursuant to a provision in the LLC operating agreement. The court rejected this argument because Lisa was not a party to the operating agreement. The operating agreement referred to the "parties" as the LLC's "Members," and Lisa held only an economic interest. The court stated that the Fifth Circuit has recognized limited circumstances in which a nonsignatory may be bound by an arbitration agreement, but there was no argument or evidence suggesting how Lisa, neither a member nor a party, was bound by the arbitration

provision. The court of appeals also clarified that Lisa was a “creditor” under the Texas Uniform Fraudulent Transfer Act because she had a right to payment or property that existed at the time of the fraudulent transfer or that arose within a reasonable time after the transfer. The court reasoned that, as an economic interest holder of the LLC, “a creature of California corporate law,” she had a right to payment and was entitled to distributions before the LLC was dissolved and Raul transferred its assets. Because the California LLC statute provides that an economic interest includes a person’s right to receive distributions from the LLC and an economic interest constitutes personal property of an assignee, Lisa had standing to bring her fraudulent transfer claim.

*Seven Hills Commercial, LLC v. Mirabal Custom Homes, Inc.*, 442 S.W.3d 706 (Tex. App.–Dallas 2014, pet. denied).

Five entities entered into an amended and restated LLC operating agreement that listed three of the entities as members and identified one of the entities as a former member and one of the entities as a former manager. One of the member entities was named as manager of the LLC. Three individuals signed the agreement one or more times in representative capacities for the five entities. The LLC sued the three entity members and two individuals whom the LLC alleged participated in one member’s breach of fiduciary duty and tortious interference with the operating agreement. The defendants and other parties and signatories to the operating agreement asserted various cross claims and counterclaims. Some of the parties to the lawsuit sought arbitration pursuant to an arbitration clause in the LLC operating agreement, and the parties disputed whether the arbitration clause was binding on all the parties to the lawsuit, whether the claims asserted fell within the scope of the arbitration clause, and who could enforce the arbitration clause.

The court of appeals held that a member and former manager who were parties to the operating agreement, as well as a nonparty individual, could compel arbitration of another member’s claim for money had and received against them. The individual who was not a party to the operating agreement was entitled to compel arbitration of the claim against him because he signed the operating agreement as an agent for a party. Based on the language of the arbitration clause, the court concluded that the members had agreed to delegate arbitrability to the arbitrator. Thus, the arbitrator would make the primary determination of whether this claim for money had and received based on alleged improper distributions fell within the scope of the arbitration clause.

The court analyzed claims by an individual and his entity (the former member) against an individual and two of that individual’s entities (one of whom was the former manager), and the court concluded that the latter could not compel the claims to arbitration. The individuals had signed the operating agreement only in their capacities as representatives of their respective entities, and one of the entities involved in these claims did not sign the operating agreement at all. The claims arose out of a contract separate and apart from the operating agreement and thus did not arise out of or relate to the operating agreement. The claims by the individual representative of the former member were based on alleged acts involving injury to the individual personally. None of these claims appeared to arise out of or related to the operating agreement.

The court of appeals next addressed the 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 a case involving a law firm partnership agreement 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 law firm partnership agreement in the other case, 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 Texas Business Organizations Code 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.” 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.

**P. Standing or Capacity to Sue**

*Flynn v. Distinctive Home Care, Inc.*, No. 5:13–CV–0936–RP, 2015 WL 1004404 (W.D. Tex. Mar. 5, 2015).

Dr. Flynn was hired as an independent contractor pediatrician and subsequently assigned all of her rights under the contract to an LLC managed by her. Later, the LLC signed a new contract to provide Dr. Flynn’s services. When that contract was terminated, Dr. Flynn sued for breach of contract. The defendants argued that Dr. Flynn lacked standing to sue as an individual for a contract that was executed by the LLC that she manages. Dr. Flynn was not a party to the contract at issue. Rather, at the time of the alleged breach, the only contract in effect was with the LLC. The court stated that “[t]he general rule in Texas is that ‘[a] member of a limited liability company lacks standing to assert claims individually where the cause of action belongs to the company.’” Dr. Flynn did not show why that rule would not apply here, and the court granted summary judgment in favor of the defendants on this claim.

*In re SMBC Healthcare, LLC*, 519 B.R. 172 (Bankr. S.D. Tex. 2014).

The president and sole member of an LLC asserted malpractice claims against the attorneys that advised the LLC to file bankruptcy. The plaintiff claimed that the attorneys negligently advised the plaintiff to file a Chapter 11 petition on behalf of the LLC, and the bankruptcy court analyzed whether the claims were direct or derivative. The court concluded that some of the claims were derivative and some were direct.

The bankruptcy court relied on case law in the corporate context to analyze whether the plaintiff’s claims were direct or derivative, and the court concluded that the plaintiff had asserted claims that were direct as well as claims that were derivative. The court relied on *Wingate v. Hajdik*, 795 S.W.2d 717, 719 (Tex.1990), in which the Texas Supreme Court stated that “a corporate stockholder cannot recover damages personally for a wrong done solely to the corporation, even though he may be injured by that wrong.” The court stated that the relevant considerations in characterizing a claim as direct or derivative are which party suffered the harm and which would receive relief. The court examined the allegations in the complaint and concluded that the plaintiff asserted injuries personal to the plaintiff that formed the basis of direct claims. The complaint alleged that the plaintiff had a personal attorney-client relationship with the defendants during which the defendants breached their fiduciary duty to the plaintiff by negligently advising him to file a Chapter 11 bankruptcy on behalf of the LLC. As a result of the alleged negligence, the plaintiff contended that he suffered losses when unpaid creditors of the LLC sued the plaintiff in his individual capacity as guarantor to recover obligations owed by the LLC. The plaintiff incurred defense costs and had judgments entered against him personally after the LLC failed to pay the debts through its bankruptcy. This harm was personal and distinct from any harm suffered by the LLC. Thus, the plaintiff’s causes of action against the defendants for negligence, breach of fiduciary duty, and violation of the DTPA that were based on suits filed against them by LLC creditors were direct causes of action that should not be dismissed. Further, the exculpatory provision in the plan did not limit the liability of the defendants for pre-petition conduct and thus did not bar the plaintiff’s claims. To the extent the complaint alleged injury based on the loss in value of the plaintiff’s ownership in the LLC (which the court referred to as “stock” or “shares”), the claims were derivative because an individual shareholder has no separate and independent right of action for injuries suffered by the corporation that merely result in the depreciation of the shareholder’s stock. The plaintiff’s causes of action that were based merely on the devaluation of the LLC’s “stock” were derivative and belonged to the LLC’s estate.

See also *Fowler v. Montis*, No. 13-13-00581-CV, 2014 WL 6602288 (Tex. App.–Corpus Christi–Edinburg Nov. 20, 2014, no pet.) (mem. op.), summarized above under the heading “LLC Property.”

See also *Ganter Group, L.L.C. v. Choice Health Care, L.L.C.*, No. 11-12-00297-CV, 2014 WL 5562945 (Tex. App.–Eastland Oct. 31, 2014, no pet.) (mem. op.), summarized above under the heading “Pre-Formation Transactions.”

## Q. Receivership

See *Hill v. Hill*, 2015 WL 1404650, \_\_ S.W.3d \_\_ (Tex. App.–Dallas 2015, pet. filed), summarized above under the heading “Dissolution/Winding Up.”

## R. Bankruptcy

*In re DeVries*, Bankruptcy No. 11-43165-DML-7, Adversary No. 12-04015-DML, 2014 WL 4294540 (Bankr. N.D. Tex. Aug. 27, 2014).

The debtor was a member in a family owned Washington LLC that operated a dairy farm in Washington. In this adversary proceeding filed by the debtor’s bankruptcy trustee against the LLC, the court determined that the LLC operating agreement was an executory contract, but the trustee rejected the contract by failing to assume it within 60 days of the petition date. Rejection of the operating agreement constituted a breach resulting in the status of assignee for the trustee under the operating agreement. As an assignee of the debtor’s economic rights, the trustee was not entitled to exercise the non-economic rights of a member. The court determined that it need not address whether certain provisions of the operating agreement were an unenforceable *ipso facto* clause because the trustee’s rejection of the agreement altered her rights in the LLC regardless of the *ipso facto* clause’s enforceability. Fact issues regarding the debtor’s insolvency at the time of redemption of some of his units in the LLC precluded summary judgment in favor of the LLC on the trustees’s claim that the redemption was a fraudulent transfer or preference, but the court concluded the remedy would be limited to the return of the debtor’s redeemed units if the trustee prevailed on these claims. Finally, the court determined that a waiver of judicial dissolution in the LLC operating agreement was unenforceable under the Washington LLC statute.

The court analyzed the LLC operating agreement to determine whether it was an executory contract under the Bankruptcy Code and concluded that the debtor had obligations sufficient to make the operating agreement an executory contract. The court stated that the majority of circuits have adopted the “Countryman definition,” under which a contract is executory “if at the time of the bankruptcy filing, the failure of either party to complete performance would constitute a material breach of the contract, thereby excusing the performance of the other party.” Further, an “executory contract” is a contract “on which performance remains due to some extent on both sides.” A contract is not executory if the only performance required by one side is the payment of money, and a contract that only imposes remote or hypothetical duties is not an executory contract. Relevant factors in evaluating an LLC operating agreement include whether the operating agreement imposes remote or hypothetical duties, requires ongoing capital contributions, and the level of managerial responsibility imposed on the debtor.” The debtor’s obligation to devote time to the LLC’s affairs was not an executory obligation because another member was vested with sole management and control of the LLC, and the debtor’s failure to participate in management did not constitute a material breach under the operating agreement. However, the court concluded that a member’s obligation to contribute additional capital and a member’s obligation to guarantee the LLC’s debt were executory obligations sufficient to make the operating agreement an executory contract. The court concluded that the operating agreement and a cross purchase agreement governing the transfer of membership units were one integrated contract that were rejected by the trustee because the trustee failed to assume the agreements within 60 days after the petition date.

Under the terms of the operating agreement, the trustee became an assignee of the debtor’s membership units and thus entitled to the debtor’s economic rights but not the non-economic rights of a member. When a member of an LLC files for bankruptcy, the member’s interest in the LLC, and any rights the member has under the LLC’s operating agreement, become property of the estate. Under Washington state law and the LLC’s operating agreement, the debtor’s ownership interest included both economic and non-economic rights. Thus, on the petition date, all of the debtor’s rights under the operating agreement, including his economic rights and non-economic rights, became property of the estate pursuant to Section 541 of the Bankruptcy Code. Section 365 provides that “the trustee, subject to the court’s approval, [may] assume or reject any executory contract,” but the contract is deemed rejected if the trustee does not assume or reject it within 60 days after the order for relief. The trustee’s failure to assume the operating agreement within 60 days after the petition date meant that the operating agreement was deemed rejected. Rejection of an executory contract constitutes a breach of the contract under Section 365(g). By rejecting the operating agreement, the trustee was relieved from performing any future obligations under it, but the operating agreement still governed the trustee’s rights under it. The operating agreement provided that a

member who breaches the operating agreement “shall attain the status of a mere assignee.” Under the operating agreement, the trustee, as an assignee, had the economic rights of the debtor but was not entitled to exercise the non-economic rights of a member.

The trustee argued that a provision of the operating agreement that provided a member shall cease to be a member and attain the status of a mere assignee upon the member's filing of a bankruptcy petition was an unenforceable *ipso facto* clause. The trustee argued that the Bankruptcy Code operates to prohibit provisions like this that are triggered by the filing of a bankruptcy. However, the court found it unnecessary to address the effect of this provision on the trustee's rights because the trustee never assumed the operating agreement. The rejection constitutes a breach of contract and altered the trustee's rights in the LLC regardless of the *ipso facto* clause's enforceability.

The trustee sought to avoid the pre-petition redemption of some of the debtor's units on the basis that the redemption was a preferential or fraudulent transfer. The units were redeemed by the LLC in satisfaction of an \$800,000 loan by the LLC to the debtor. If the trustee prevailed on this claim, the trustee sought to recover the property transferred, i.e., the redeemed units, or the value of the property pursuant to Section 550 of the Bankruptcy Code. The court determined that valuation of the redeemed units would be difficult and costly and that recovery of the units themselves would be the appropriate remedy. Fact issues regarding the solvency of the debtor at the time of the transfers precluded summary judgment in favor of the trustee on these preferential and fraudulent transfer claims.

The trustee prevailed on a claim that a waiver of judicial dissolution in the LLC operating agreement was unenforceable under the Washington Limited Liability Company Act. Although the Washington LLC Act provides that “it is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements,” the court concluded that the plain language of the statute indicated that an operating agreement may not deprive a member of the statutory right to seek judicial dissolution on grounds specified in the statute. The Washington LLC Act provides default rules and allows members to alter many of these rules. In these instances, the statute often prefaces the rule by phrases such as “unless the limited liability company agreement provides otherwise” or “unless the certificate of formation provides otherwise.” The trustee contended that the judicial dissolution provision should be deemed mandatory because it does not contain the permissive phrase “unless the limited liability company agreement provides otherwise.” The bankruptcy court agreed. The court did not believe it was mere coincidence that the legislature specifically included language in certain provisions to reflect their permissive nature and declined to include similar language in others. Thus, the provision in the operating agreement providing for the waiver of judicial dissolution was not enforceable.

*In re Wilson*, No. 11–50396–rlj–7, 2014 WL 3700634 (Bankr. N.D. Tex. July 24, 2014).

The trustee sought permission to sell by auction 200 certificated LLC membership units held in the name of the debtor, and the debtor and another member argued that the sale was subject to valid transfer restrictions in the company agreement. A creditor of the debtor made an offer for the units and favored auctioning the units. Given the nature of the asset as defined by state law; the terms of the transfer restrictions in the company agreement; the motivations and intentions of the parties in their respective roles as members or creditors; and the procedures that had been employed thus far (which did not include notice to other members as provided by the transfer restrictions), the court authorized the trustee's sale of the debtor's 200 units at a sealed-bid auction of which the members would have notice and in which the members would have the opportunity to match the high bid consistent with the transfer restrictions in the company agreement. The court stated that the nature of the interest sold was defined by the Texas Business Organizations Code as it applies to the assignment or transfer of a member's interests in an LLC.

The Wilsons and an LLC in which Mr. Wilson held 200 units both filed Chapter 11 bankruptcy petitions after a large judgment was obtained against the Wilsons and the LLC. The Wilsons' case was converted to a Chapter 7 case, and the judgment creditor, Custom Food Group, LP (“CFG”) sought to purchase Mr. Wilson's units in the LLC for \$7,500. The trustee sought permission to sell the 200 units to CFG for \$7,500, subject to other competing bids coming in before a specified deadline. Wilson and another member, Rogers, objected to the sale on the basis of transfer restrictions contained in the company agreement. As a member and interest holder, Rogers argued that he could invoke the transfer restrictions affording him the first right to purchase the units at a price offered by an outside bidder. Rogers also pointed out that he and other members of the LLC were not provided with timely notice of any sale by the trustee.



The company agreement for the LLC (both an original agreement between the initial members and an amended and restated company agreement adopted when an additional member was admitted under the LLC's reorganization plan) provided the structure, makeup, and mechanics of the LLC. It set forth the LLC's purpose to conduct a lawful business; provisions regarding the managers of the LLC—their rights, duties, potential removal, and replacement; requirements regarding regular and special meetings of the company; the identity and ownership (by units and percentage) of the member-managers and how their capital accounts were created and accounted for; provisions regarding the transfer of a membership interest; and provisions regarding dissolution and liquidation. Of particular relevance in this case was Article VII, which addressed potential transfers of a member's interest. The transfer provisions provided that any member who sought to transfer his interest must first provide written notice to the other members of the proposed transfer, and the other members then had the option of acquiring the interest proposed to be transferred at “a price equal to the lesser of the Book Value of the Interest and the amount offered by the proposed transferee.” The “Book Value of the Interest” was a defined term and was to be determined by a CPA. If multiple non-transferring members sought to acquire the interest, they did so on a pro rata basis. The company agreement did not require additional capital contributions or loans by the members.

The trustee proposed to auction Wilson's 200 units to realize their value as an estate asset, and she did not propose to sell any particular allocable interest or set of interests represented by the units—such as economic, management, voting, right to information, etc. The trustee simply sought to sell what she could sell to liquidate the units' value. CFG, the largest creditor in the case, advocated that the trustee hold a private sale in the form of an auction between CFG and the members of the LLC. Wilson conceded that the trustee could attempt to sell his 200 units (despite an exemption claim he had made), but argued that CFG's bid of \$7,500 was not a true value for the units because the bid was motivated by CFG's desire to commit mischief as a competitor of the LLC. CFG denied this accusation. Rogers and the LLC were aligned with Wilson and argued that the transfer restrictions in the company agreement applied to any proposed transfer or assignment of a member's units and that the restrictions granted the other members the first right to purchase Wilson's units at the lesser of CFG's bid price of \$7,500 or the book value as defined in the company agreement. Rogers further proposed that he simply match CFG's offer of \$7,500, and, in so doing, would waive any problems regarding notice of the sale as well as any right to purchase for book value (which he argued was probably zero). The court found no reason not to approve Rogers' proposal if either the original or amended and restated company agreement applied and the transfer restrictions controlled. CFG, however, argued that neither the company agreement nor the restriction on transfer of members' units should apply in this case.

CFG first argued that there was no valid and controlling company agreement because the restated company agreement misstated the number of units owned by the members and was thus rendered invalid. (The number of units recited in the agreement did not match the number of units shown on the newly issued certificates, but the percentages recited in the agreement matched the numbers on the certificates.) Further, it argued that the company agreement was not specifically approved by the court. The court stated that this argument attempted to avoid Wilson's claim that the restrictions controlled because the Texas Business Organizations Code specifically endorses such restrictions. CFG responded that the statutory provision relied upon applies to corporations and not to LLCs. As a follow-on argument, CFG contended that Texas case law indicates that such restrictions should not be enforced as a way to prevent an involuntary sale such as the trustee's proposed auction here. At a minimum, according to CFG, Texas law authorizes an assignment of the economic benefit to be derived from the 200 LLC units, and this economic benefit could be sold by the trustee.

With regard to CFG's argument that the company agreement was invalid based on a misstatement in the number of units owed by the members, the court “fail[ed] to appreciate why an easily corrected number in a company agreement cannot be easily corrected without disavowing the agreement.” No authority was provided to the court showing the necessity of invalidating the existence of a company agreement. The court refuted an argument by CFG that the legend regarding restrictions contained on the cancelled certificates did not appear on the newly issued certificates. The restrictions were referenced on the face of each of the newly issued certificates and stated in italics: “Transfer of these Units is subject to restrictions in the Operating Agreement/ Company Agreement/ Regulations for this Limited Liability Company.” The court further pointed out that, regardless of the existence of the legend on the certificate, CFG was made aware of the restrictions during the proceedings.

The court next addressed the enforceability of the transfer restrictions under the Texas Business Organizations Code (“BOC”). The court characterized the issue as whether the restrictions in this LLC were enforceable. No argument was made that the restrictions were generally unenforceable. The court found no

provision in Title 3 of the BOC, which applies to LLCs, that limited the use or allowance of the restrictions at issue. The court noted further that membership units in an LLC may be assigned, but the assignment does not entitle the assignee to participate in management, to become a member, or to exercise the rights of a member. Tex. Bus. Orgs. Code § 101.108. The assignee is entitled to an allocation of the economic attributes—income, gain, loss, distributions, etc.—but only to the extent that such benefits have been assigned, and an assignee may become a member on approval of all members. *Id.* § 101.109. Furthermore, the court’s review of Chapter 101 of the BOC revealed that an LLC may, after formation, issue membership units to any person with approval of all members pursuant to Section 101.105, and that the membership interests may be subject to a charging order upon application of a judgment creditor of a member under Section 101.112. The court explained that a charging order is a lien on the interest that cannot be foreclosed but does entitle the lienholder-creditor to receive any distribution to which the judgment debtor would be entitled. The charging order is the exclusive remedy by which a judgment creditor of a member may satisfy a judgment out of the membership interest. Thus, absent the restrictions, the court said it appeared that the trustee could sell an interest in Wilson's units to CFG that would then allow CFG to recover certain economic benefits attributable to Wilson's 20% interest.

CFG contended that the trustee was an assignee of Wilson's interests in the LLC and that, as an assignee, the trustee held Wilson's rights to distributions deriving from his 20% membership interest pursuant to Section 101.108 of the BOC and could sell the distribution rights. But the court pointed out that Section 541(a) of the Bankruptcy Code expressly provides that “all legal or equitable interests of the debtor in property as of the commencement of the case” constitute estate property. Since all interests attributable to Wilson's ownership in the units passed to the estate for administration by the trustee upon the bankruptcy filing, the trustee was subject to applicable law, including the BOC, concerning any proposed sale or transfer of Wilson's units. The BOC provides that any assignment of a member's interest grants to the assignee limited rights, i.e., the assignor's allocation of economic benefits, to the extent such items are assigned, and rights to reasonable information and inspection of books and records of the company. Tex. Bus. Orgs. Code § 101.109. The court also reiterated that the BOC provides for a judgment creditor of a member to obtain a charging order that creates a non-forecloseable lien against the interest, which is the exclusive remedy of a judgment creditor against a member's interest. The court held that the transfer restrictions contained in the company agreement limited Wilson's, and thus the trustee's, ability to sell the units, but also provided that Wilson, as a member, could transfer the entirety of his interests represented by the units. The transfer restrictions specifically stated that they applied to “all or any portion of the Member's entire membership interest,” and a “membership interest” was defined to mean such “Member's interest in profit and loss, capital, management, right to vote, and any other interest provided in the Company Agreement to such Member.” The transfer by a member of the entirety of such member's interest was subject to the other provisions contained in the company agreement that dictated that other members had a first right to purchase the units at the lesser of the proposed purchase price or the defined book value. This option, CFG contended, undermined any sale, which the court found to be a legitimate concern in light of the assumed book value of the units. The question was whether or to what extent the transfer restrictions should apply since the apparent effect would be to prevent the trustee from recovering anything for the 200 units. That result would be unfair according to the court, especially given the rights of a judgment creditor to impose a charging order on the 200 units. Here, however, the trustee sought to sell the units rather than seeking a charging order or seeking to sell an asset that was subject to a charging order. As a bankruptcy trustee, the trustee was required to administer the asset, i.e., to reduce it to money in a manner as expeditiously as is compatible with the best interests of all parties. 11 U.S.C. § 704(a)(1).

CFG made the alternative argument that the company agreement was deemed rejected under Section 365(d)(1) of the Bankruptcy Code by the trustee's failure to timely assume the agreement as an executory contract, but the court did not construe the company agreement to be an executory contract and thus rejected this argument. First, neither the trustee nor the other members, i.e., the parties to the agreement, contended that the agreement was an executory contract. Second, all the parties, including CFG, were parties to the confirmation hearing on the Chapter 11 plans of both the LLC and the Wilsons, and no party then took the position that the LLC's company agreement was an executory contract. The Wilsons served as the day-to-day managers of the company while the other members were mostly passive investors. By the terms of the company agreement, they were each designated to serve as managers. The members, subject to the requisite votes, were each granted certain powers—to manage the company, to enter into contracts, to take certain actions concerning major transactions of the company or significant changes in the company's structure. They were not obligated to make additional capital contributions.

They in essence had the right to participate in the business and affairs of the company, but were not required to do so. The court did not consider these rights to be executory duties giving rise to an executory contract.

The court concluded that the trustee should be able to realize fair value for Wilson's 200 units in the LLC. The transfer restrictions in the company agreement, as applicable here, potentially undermined that goal. Rogers' proposal to waive the option to purchase at book value addressed the problem, and the other members' right to match a proposed purchase by CFG or other third party would not prevent the trustee's ability to obtain fair value. The court was not offended by the \$7,500 purchase price, and the court thus exercised the discretion it had as a bankruptcy court to strike a balance between fairness, finality, integrity, and maximization of assets. The court authorized the trustee's sale of Wilson's 200 units and stated that the nature of the interest sold was defined by the BOC as it applies to the assignment or transfer of a member's interests in an LLC. The sale was to be made by sealed bids to be submitted at a time and location specified by the trustee. The members of the LLC were required to be provided notice of the sale and an opportunity to bid, and the members had the opportunity to match the high bid as provided for in the company agreement.

See also *In re Packer*, 520 B.R. 520 (Bankr. E.D. Tex. 2014), summarized above under the heading “Veil Piercing.”

See also *In re SMBC Healthcare, LLC*, 519 B.R. 172 (Bankr. S.D. Tex. 2014), summarized above under the heading “Standing or Capacity to Sue.”

## S. Securities Laws

*Sun River Energy, Inc. v. McMillan*, Civil Action No. 3:13-CV-2456-D, 2015 WL 1378713 (N.D. Tex. Mar. 25, 2015).

The plaintiff sued to recover short-swing profits under Section 16(b) of the Securities and Exchange Act of 1934 based on numerous transactions involving shares in the plaintiff owned by an LLC. The court held that the “pecuniary interest” of a 50% member for purposes of determining the member’s beneficial ownership of shares sold by the LLC in a buyout of the other member was 50% even though after the transaction at issue the member owned 100% of the LLC.

An LLC and one of its members, McMillan, entered into an agreement with the other member, Pingel, under which Pingel agreed to sell all of his interest in the LLC in exchange for consideration that included 350,000 shares of stock in the plaintiff owned by the LLC. In a previous opinion, the court held that this transaction was a “sale” of the stock for purposes of short-swing profit liability under Section 16(b) of the Securities and Exchange Act. In this opinion, the court addressed a dispute as to the amount of McMillan’s beneficial ownership in the shares deemed to be sold by the LLC in the buyout of Pingel. McMillan and the LLC maintained that McMillan's beneficial interest in the deemed sale of the shares to Pingel was limited to 175,000 shares based on McMillan’s pecuniary interest, i.e., his 50% ownership interest, in the LLC at the time of the sale. The plaintiff argued that McMillan had a pecuniary interest in all 350,000 of the shares sold in the Pingel transaction, reasoning that the pecuniary interest in the sale belonged entirely to McMillan because only he, as the sole remaining investor in the LLC, would have enjoyed the risks and rewards of owning these shares had the LLC not sold them, and only he had the opportunity to profit from the sale because he was the sole remaining investor in the LLC and stood to enjoy 100% of the benefits that it received from the transaction. The plaintiff also asserted that the 50% ownership interest of Pingel in the LLC should not be counted because he had no opportunity to profit from the sale. The court disagreed with the plaintiff’s reasoning. The plaintiff relied on a definition of “pecuniary interest”—“the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction”—to determine the *extent* of that interest. However, that provision specifies what is necessary *to have* a pecuniary interest rather than *the extent of* that interest. A person has a “pecuniary interest” if he has *any* direct or indirect opportunity to profit or share in any profit derived from a transaction. 17 C.F.R. § 240.16a–1(a)(2)(i). The regulations contain a standard of measurement, or *extent* of pecuniary interest, in another context. Under 17 C.F.R. § 240.16a–1(a)(2)(ii)(B), a general partner's indirect pecuniary interest in the portfolio securities held by a general or limited partnership is the general partner's proportionate interest, as evidenced by the partnership agreement in effect at the time of the transaction and the partnership's most recent financial statements. The regulations define the *extent* of a person's pecuniary interest (here, an indirect pecuniary interest) based on the interest “in effect at the time of the

transaction,” and there is no indication in the regulations that the interests of owners in an LLC’s portfolio securities should be treated differently. The court also disagreed with the plaintiff’s assertion that the 50% ownership interest of Pingel in the LLC should not be counted. Pingel had a pecuniary interest in the transaction, even though he was the purchaser of the shares, because they were being sold by the LLC, in which Pingel had an ownership interest at the time of the sale. Although the transaction itself extinguished that ownership interest, it did not deprive Pingel of the opportunity, directly or indirectly, to profit or share in any profit from the transaction. Thus, the court held that McMillan’s pecuniary interest in the LLC was determined according to what it was at the time of the transaction, which was 50%.

#### **T. Eminent Domain**

*Texas Rice Land Partners, Ltd. v. Denbury Green Pipeline–Texas, LLC*, 457 S.W.3d 115 (Tex. App.–Beaumont Feb. 12, 2015, pet. filed).

The court held that Section 2.105 of the Business Organizations Code does not provide an additional source of condemnation authority beyond that provided by the Natural Resources Code. Section 2.105 of the Business Organizations Code provides that an LLC engaged as a common carrier engaged in the pipeline business for the purpose of transporting various products has all the rights and powers conferred on a common carrier by Sections 111.019 through 111.022 of the Texas Natural Resources Code. Section 111.019 of the Natural Resources Code gives common carriers the power of eminent domain to enter and condemn the land, rights-of-way, easements, and property of any person or corporation necessary for the construction, maintenance, or operation of a common carrier pipeline. To exercise this right of eminent domain, an entity must meet the statute’s definition of “common carrier.” Section 111.002(6) of the Natural Resources Code defines a “common carrier.” According to the court, to have the right of eminent domain conferred by Chapter 111, as referenced in Section 2.105 of the Business Organizations Code, an entity must still meet Chapter 111’s common carrier requirement. Accordingly, Section 2.105 is not an independent basis for exercising eminent domain authority.

#### **U. Effect of Reorganization**

*Abel v. Alexander Oil Company*, 2014 WL 6851587, \_\_ S.W.3d \_\_ (Tex. App.–Houston [14<sup>th</sup> Dist.] 2014, no pet.).

Applying the rule that a guaranty must be strictly construed, the court held that a creditor who had obtained a guaranty of the debts of a sole proprietorship was not able to hold the guarantor liable for the debts of an LLC that took over the business of the sole proprietorship even if the owner of the sole proprietorship was personally liable for the LLC’s obligations as an agent for an undisclosed principal.

John Steele d/b/a John Steele Trucking began buying fuel on an open account from Alexander Oil Company (“Alexander Oil”). The credit application and payment agreement for this account listed “Company Name: John Steele” and stated that the form of the company was a sole proprietorship. Rena Abel, John Steele’s mother-in-law, executed a contemporaneous personal guaranty to Alexander Oil, guaranteeing the applicant company’s obligations. Shannon Steele (John Steele’s wife and Abel’s daughter) later formed John Steele Trucking, LLC, which took over the business of the sole proprietorship and began using the Alexander Oil account to purchase fuel. When the LLC fell behind in paying its bills, Alexander Oil obtained personal guaranties from the LLC, John Steele, and Shannon Steele. It did not obtain a new guaranty from Abel. Alexander Oil sued the sole proprietorship, the LLC, John Steele, and Shannon Steele for large balances owed on the account. This appeal dealt with Alexander Oil’s attempt to collect amounts owed for fuel purchased by the LLC against Abel as guarantor on the John Steele Trucking account. Abel argued that she could not be held liable under her guaranty of John Steele’s sole proprietorship for debts incurred by the LLC.

The court relied on the principle that a guaranty must be strictly construed to conclude that Abel was not liable for the LLC’s purchases. The jury found that John Steele was personally liable for amounts owed by the LLC because he acted as an agent of the LLC without disclosing his representative capacity and the true identity of the principal. However, the court stated that Abel’s personal guarantee of “full and prompt payment to Alexander Oil Company of all amounts due by Company [John’s sole proprietorship] to Alexander Oil Company” was not a guaranty of John’s obligations to Alexander Oil as an individual, only his obligations as a sole proprietor. There was no evidence to support a finding that John Steele’s sole proprietorship owned any amount to Alexander Oil,

and the evidence established that the finding of damages against John Steele was based only on amounts for which he was liable as an agent of the LLC. Since the court construed Abel's guaranty as guaranteeing only the obligations of John Steele as a sole proprietor and not as an individual, Abel was not liable for the amount Johns Steele owed Alexander Oil.

#### **V. Pro Se Representation**

*Securities and Exchange Commission v. Thomas*, Civil Action No. 3:13-CV-739-L, 2015 WL 568983 (N.D. Tex. Feb. 11, 2015).

Thomas filed a motion to vacate a default judgment on behalf of herself and two entities— an LLC and a limited partnership. The court stated that federal law recognizes an individual's general right to proceed pro se with respect to her own claims or claims against her personally but does not authorize unlicensed lay persons to represent anyone other than themselves. Business entities such as LLCs—as fictional legal persons—have no right to appear pro se, and must be represented by licensed counsel. Thus, the court considered the motion as to Thomas but not as to the LLC or limited partnership.