

**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

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### 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. Case law surveys that include cases from prior years are available on Professor Miller's profile page at the Baylor Law School web site.

### II. Recent Texas Cases Involving Partnerships

#### A. Creation/Existence of General Partnership

*Yee v. Anji Technologies, LLC*, No. 05-18-00662-CV, 2019 WL 2120290 (Tex. App.—Dallas May 15, 2019, no pet. h.) (mem. op.).

The court of appeals held that an oral partnership agreement was not enforceable because the agreement could not be performed within one year and the partial performance exception did not apply. However, the would-be partner's claims for quantum meruit, promissory estoppel, and enforcement of an oral agreement entered into at the time of termination of her employment were not barred.

Wendy Yee was employed by Anji Technologies, LLC ("Anji") as a senior vice president for several years. After Anji terminated her employment, Yee sued, claiming she was entitled to (1) fifty percent of Anji's profits from 2012 through 2015 under an oral partnership agreement and (2) fifty percent of Anji's profits from a certain project under an oral agreement made when her employment was terminated (the "Alcara agreement"). Yee asserted claims for breach of contract, promissory estoppel, breach of fiduciary duty, and quantum meruit.

Anji moved for summary judgment on all of Yee's claims on the ground the partnership agreement did not comply with the statute of frauds. The trial court granted summary judgment on all of Yee's claims. The court of appeals affirmed the trial court's summary judgment as to the claims for breach of the partnership agreement and breach of fiduciary duty because the oral partnership agreement was unenforceable under the statute of frauds. The court of appeals reversed the trial court's summary judgment on the claims for quantum meruit, promissory estoppel, and breach of the Alcara agreement because those claims were not barred by the statute of frauds.

The court of appeals concluded that the summary-judgment evidence showed that both Yee and Anji anticipated that the oral partnership agreement—under which Yee would provide certain services, the owner of Anji would be responsible for all aspects of software and technical support, and Yee and Anji would split the profits—would take much longer than a year. Anji had been in business five years already, and the purpose of the partnership was to increase Anji's client base and workforce. Yee knew profits were to be reinvested in the partnership, and she had made a personal decision not to seek any distribution of profits for five years. Thus, the court held that Anji met its burden of establishing that the statute of frauds barred Yee's claims for breach of the partnership agreement and breach of fiduciary duties arising from the agreement.

Yee claimed that the partial-performance exception to the statute of frauds applied in this case, but the court held that she failed to raise a fact issue as to whether work she allegedly performed for no compensation and personal funds she allegedly spent on Anji's costs and expenses were unequivocally referable to the partnership agreement.

Although the partnership agreement was unenforceable based on the statute of frauds, the court of appeals held that Yee's claims for quantum meruit (under which she sought to recover the reasonable value of the goods and services she provided to Anji) and promissory estoppel (under which she sought to recover out-of-pocket expenses) were not barred by the statute of frauds. Thus, the court of appeals reversed the trial court's summary judgment against Yee on those claims.

Additionally, there was nothing about the oral Alcara agreement—which the parties allegedly entered into at the time Yee was terminated and under which Yee would be paid fifty percent of the profits from a project that

had just been completed—that would suggest it could not be performed within one year. Thus, Anji should not have been granted summary judgment on that claim.

***Hammerhead Managing Partners, LLC v. Nostra Terra Oil & Gas Co., PLC***, Civil Action No. 3:18-CV-1160-N, 2019 WL 1403363 (N.D. Tex. Mar. 27, 2019).

The court dismissed the plaintiff’s breach-of-fiduciary-duty claim because the plaintiff’s complaint contained only conclusory allegations of the elements of a joint venture and did not identify any other special relationship giving rise to a fiduciary duty.

Hammerhead Managing Partners, LLC (“Hammerhead”) held a working interest in a tract of land known as the Pine Mills Oil Field. Hammerhead sued the other two working interest owners asserting various claims after they entered into a joint operating agreement without including Hammerhead. The court granted the defendants’ motion to dismiss several of Hammerhead’s claims, including the claim for breach of fiduciary duty. In that regard, the court explained:

Hammerhead alleges that Defendants Cue and GFP owed fiduciary duties to Hammerhead because they formed a joint venture under Texas law. The Court notes that merely pleading that the parties share an undivided interest in Pine Mill is not by itself sufficient because working interest owners in the same tract of land do not automatically owe each other fiduciary duties. *Zimmerman*, 409 S.W.2d at 614.

A joint venture exists when there is, among other things, an agreement to share profits and losses and a mutual right of control or management of the venture. *Pitts & Collard, L.L.P. v. Schechter*, 369 S.W.3d 301, 319 (Tex. App.—Houston [1st Dist.] 2011, no pet.). The Complaint does not contain factual allegations supporting the existence of a joint venture, and instead contains only a conclusory recital of the elements of a joint venture. Compl. at 21. And Hammerhead identifies no other special relationship, other than co-tenancy in the Pine Mills tract, that gives rise to a fiduciary relationship.

In a footnote, the court commented that the court found it interesting that Hammerhead sought to be part of and bound by the joint operating agreement when the joint operating agreement itself disclaimed any partnership.

***Fredieu v. W&T Offshore, Inc.***, No. 14-16-00511-CV, 2018 WL 5556065 (Tex. App.—Houston [14th Dist.] Oct. 30, 2018, pet. filed).

In the course of addressing application of a nine-factor test for determining whether an injured plaintiff was a borrowed employee at the time of his injury (such that workers’ compensation benefits under the Longshore and Harbor Workers’ Compensation Act (“LHWCA”) would be his sole remedy), the court discussed the *Ingram* totality-of-the-circumstances test for determining the existence of a partnership.

In discussing the nine-factor test for determining LHWCA borrowed-employee status from *Ruiz v. Shell Oil Co.*, 413 F.2d 310 (5th Cir. 1969), the court referred to the test as a totality-of-the-circumstances assessment. The court then noted that “Texas law also employs a multi-factor, totality-of-the-circumstances approach to address determinations in certain circumstances,” including “determining the existence of a partnership based on five factors identified in the Texas Revised Partnership Act.” (The court cited *Ingram v. Deere*, 288 S.W.3d 886, 898 (Tex. 2009) and Tex. Bus. Orgs. Code § 152.051(b) for this proposition.) In analogizing to *Ingram*, the court observed:

Our analysis is informed by *Ingram*’s discussion of legal sufficiency review in an analogous totality-of-the-circumstances situation, which provides some measure of guidance for the inquiry here. According to *Ingram*, legal sufficiency review of a jury determination based on a multi-factor test involves consideration of evidence along a “continuum” and a “spectrum.”

At one end of this spectrum, “an absence of any evidence of the factors will preclude the recognition of a partnership under Texas law.” *Ingram*, 288 S.W.3d at 898. “Even conclusive evidence of only one factor normally will be insufficient to establish the existence of a partnership.” *Id.* “On the other end of the spectrum, conclusive evidence of all of the . . . factors will establish the existence of a partnership as a matter of law.” *Id.* “The challenge of the

totality-of-the-circumstances test will be its application between these two points on the continuum.” *Id.*

*Ingram*’s resolution did not require the court to identify a mid-continuum tipping point at which the balance of competing and controverted factors provides legally sufficient evidence to support a fact finder’s determination under a totality-of-the-circumstances standard. Compare *Ingram*, 288 S.W.3d at 904 (“In this case, Deere has not provided legally sufficient evidence of any of the five TRPA factors to prove the existence of a partnership.”), with *Lentz Eng’g, L.C. v. Brown*, No. 14-10-00610-CV, 2011 WL 4449655, at \*4 (Tex. App.—Houston [14th Dist.] Sept. 27, 2011, no pet.) (mem. op.) (legally sufficient evidence supported finding after bench trial that no partnership existed; intent evidence was controverted, and uncontroverted evidence of profit splitting and shared control did not conclusively establish existence of partnership under totality-of-the-circumstances standard).

We apply *Ingram*’s “spectrum” and “continuum” approach to our legal sufficiency review in connection with the *Ruiz* factors discussed below.

The court ultimately concluded that, “[u]nlike *Ingram*, the pertinent factors here are disputed in part and do not all point conclusively in the same direction.” Accordingly, the case fell “somewhere in the middle of the ‘continuum’ and ‘spectrum’ described in *Ingram*, 288 S.W.3d at 898, which arises when legal sufficiency review standards are applied to a flexible, multi-factor test.” As the court concluded:

This case’s middle location on the spectrum confirms that deciding [the plaintiff’s] status was the jury’s determination to make based on its assessment of multiple factors . . . . Deciding [the plaintiff’s] status was not a matter-of-law determination to be made by the trial court because certain individual factors are disputed, and because the factors on balance do not “overwhelmingly point to borrowed employee status.”

The jury made its determination by answering “No” in response to Question No. 4. Legally sufficient evidence supports the jury’s resolution of disputed individual factors in [the plaintiff’s] favor, and the jury’s resolution of Question No. 4 in [the plaintiff’s] favor [was] based on its consideration of all *Ruiz* factors on balance. Therefore, the jury’s “No” answer on borrowed employee status must be upheld.

***Henderson v. Gordon***, No. 01-16-01007-CV, 2018 WL 3848777 (Tex. App.—Houston [1st Dist.] Aug. 14, 2018, no pet.) (mem. op.).

The court of appeals held that the trial court did not err in interpreting a co-ownership agreement and amendment as a matter of law and granting summary judgment to appellees on their breach-of-contract claim.

Appellants, Thomas J. Henderson, individually and as Trustee of Monrovia Avenue Trust, and E.K. Huotari (collectively, “appellants”), challenge the trial court’s judgment in favor of appellees, Marvin J. Gordon and Myra E. Gordon, individually and as co-trustees of the M & M Gordon Trust (“Gordon Trust”) (collectively, “appellees”), on appellees’ claim against appellants for breach of contract. Appellees alleged that Gordon Trust entered into a Co-Ownership Agreement (the “Agreement”) with appellants regarding their investments in a property located at 12727 Westheimer Road, Houston, Texas (the “property”). Due to “a number of issues” between the parties, they subsequently entered into a First Amendment to the Agreement (the “Amendment”), in which Gordon Trust agreed to not sell its interest in the property for three years in exchange for the guarantee that it would be paid a minimum of \$656,000 for its interest in the property upon any disposition of ownership pursuant to the Agreement. Appellees further alleged that Gordon Trust, pursuant to the Amendment, refrained from exercising its right to sell its interest in the property for three years. After that time, the property sold for \$2.8 million. Appellees asserted a claim for breach of contract and sought a declaration that they were entitled to receive \$656,000 from the sale proceeds as well as an allocation of 40% of the seller’s closing charges attributed to them for federal income tax purposes.

Appellants refused to consent to the distribution of the amounts claimed by appellees. In part, appellants argued that the interpretation of the Amendment proposed by appellees would mandate its reformation because it would otherwise result in partnership tax treatment in violation of Section 18 of the Agreement:

The Owners agree that nothing in this Agreement or in connection with the ownership of the Property shall be construed in a manner that would result in any Owner becoming responsible for the other Owners' tax liability or status. . . . In no event shall any provision of this Agreement be construed as creating or evidencing a joint venture or partnership relationship among the Owners with respect to the Property. The Owners agree and acknowledge that to the extent required to ensure that the relationship among them is a co-ownership relationship as opposed to a joint venture or a partnership for federal income tax purposes, any provisions hereof shall be automatically reformed and not modified in the manner necessary to ensure that this Agreement does not create such a joint venture or partnership relationship.

In support of appellants' argument, a CPA testified that "any special allocation and/or minimum distributions as set forth in the . . . Amendment to the [ ] Agreement . . . dated February 1, 2008, will necessarily force the tenants in common venture to report under Subchapter K of the Internal Revenue Code, otherwise known as partnership taxation." The court of appeals, however, rejected the appellants' argument, in part because the Amendment was unambiguous:

Finally, appellants assert that the interpretation of the Amendment proposed by appellees would result in the relationship being taxed as a partnership in violation of Section 18 of the Agreement. However, Section 1 of the Amendment specifically provides that the parties intended the guaranteed-minimum payment "[n]otwithstanding any contrary provisions of the Agreement." And in Section 2 of the Amendment, the parties specifically "consent[ed] to, ratif[ied] and approve[d] [of] th[e] Amendment in its entirety, and agree[d] to be bound by the terms and provisions of the Agreement as amended . . . notwithstanding any contrary rights and privileges which may be contained in the Agreement." Thus, the plain language of the Amendment reveals that the parties intended to modify the Agreement as stated in the Amendment, and they further intended for the provisions of the Amendment to control over any contrary provisions contained in the Agreement.

*Westergren v. Houston Pilots Association*, 566 S.W.3d 7 (Tex. App.—Houston [14th Dist.] 2018, no pet.).

The court of appeals affirmed the trial court's grant of summary judgment for Houston Pilots Association on the grounds that it was entitled to statutory immunity regardless of whether it was an unincorporated association or a general partnership.

The decision addressed whether appellee Houston Pilots Association ("Houston Pilots") was entitled to immunity from liability under federal maritime law or Texas statutory law for claims arising from the collision of two vessels in the Houston Ship Channel. At the time of the collision, two members of Houston Pilots were piloting the vessels in heavy fog near Morgan's Point. Appellants, homeowners living near the site, alleged that the collision released 88,200 gallons of methyl tertiary butyl ether ("MTBE"), causing environmental damage to their property and sickening two of them. Appellants contended that Houston Pilots' alleged negligence was a cause of the collision because the association failed to train and supervise the pilots, and it undertook to implement navigation standards but failed to do so. The trial court granted summary judgment for Houston Pilots.

The court of appeals concluded that § 66.082 of the Texas Transportation Code, and not federal maritime law, governed the claims asserted by appellants. Section 66.082 states that "[a] pilot is not liable directly or as a member of an organization of pilots for any claim that: (1) arises from an act or omission of another pilot or organization of pilots; and (2) relates directly or indirectly to pilot services." The parties agreed that Houston Pilots was either an unincorporated association or a general partnership, and the court concluded that, under either characterization, a judgment against Houston Pilots would result in liability for each of the individual pilots "as a member of an organization of pilots."

With respect to unincorporated associations, the court noted that unincorporated associations historically were not considered separate legal entities and had no existence apart from their individual members. Although unincorporated associations may now sue and be sued in their own names, article 6135 of the revised civil statutes provides that any judgment against such an association "shall be as conclusive on the . . . members thereof as if they were individually parties to [the] suit[ ]." Under this statute, a judgment holding Houston Pilots liable on the appellants' claims would be conclusive on the individual member pilots as if they were parties. As a result, the court



concluded that “a judgment against Houston Pilots as an unincorporated association would hold each pilot ‘liable . . . as a member of an organization of pilots.’” Tex. Transp. Code § 66.082.

With respect to general partnerships, the court observed that, under Texas law, “an association of two or more persons to carry on a business for profit as owners creates a partnership.” Several factors can indicate the creation of a partnership, including the right to receive a share of profits and participation in or right to control the business. According to the court, the appellants correctly pointed out that whether an arrangement is considered a partnership often presents a question of fact, and that a partnership is a distinct entity that may be sued in its own name without joinder of the partners. Nevertheless, the court concluded that the personal liability of partners would run afoul of § 66.082:

Yet, even if Houston Pilots were a general partnership, each individual partner pilot would be jointly and severally liable for a judgment against the partnership. In general, “all partners are jointly and severally liable for all obligations of the partnership.” Tex. Bus. Orgs. Code § 152.304(a). “This personal liability, undoubtedly a[ ] . . . feature [of the aggregate theory of partnership], is a defining characteristic of the partnership form and distinguishes it from other entity types.” *Am. Star Energy*, 457 S.W.3d at 429. In addition, a judgment creditor of a general partnership can immediately enforce that judgment by execution against the joint property of the partners and, in some circumstances, can also execute against the individual property of partners without first seeking satisfaction from partnership property. *Id.* at 429-430 & n.2; *see* Tex. Bus. Orgs. Code §§ 152.306(b)-(c). [As with an unincorporated association, a judgment creditor of a partnership cannot execute against the individual property of partners without serving them. Tex. Bus. Orgs. Code § 152.306(a). But the judgment against the partnership generally is conclusive of the individual partners’ joint and several liability. *Id.* § 152.304(a).] For these reasons, a judgment against Houston Pilots as a general partnership would likewise hold each partner pilot “liable . . . as a member of an organization of pilots”—a result the Legislature has prohibited. Tex. Transp. Code § 66.082.

The court also concluded that, “as a matter of law the Homeowners’ claims arise from ‘an act or omission of another pilot or an organization of pilots,’” and that “as a matter of law the Homeowners’ claims ‘relate[ ] directly or indirectly to pilot services’ as required by section 66.082(2).” The trial court’s summary judgment in favor of Houston Pilots was affirmed.

***Pacific Energy & Mining Co. v. Fidelity Exploration & Production Co.***, No. 01-17-00594-CV, 2018 WL 3543103 (Tex. App.—Houston [1st Dist.] July 24, 2018, no pet.) (mem. op.).

The court of appeals affirmed the trial court’s grant of summary judgment on various issues, including the absence of a partnership.

Fidelity was an oil and gas operator. It entered into an Asset Purchase Agreement (“APA”) to sell assets to Pacific. With Fidelity’s consent, Pacific assigned its rights in the APA to Norman Oil & Gas, LLC (“Norman”). For various reasons, the deals between the parties fell apart. Pacific sued Fidelity and Norman and asserted multiple claims. Fidelity and Norman moved for summary judgment, which the trial court granted. Pacific appealed.

One of Pacific’s claims was that Norman and Pacific had entered into a joint venture and that Norman had breached its fiduciary duties. Fidelity argued that there was no joint venture and, as a result, it could not have conspired to breach any fiduciary duty owed by Norman. Fidelity further asserted that, in the absence of fiduciary obligations owed by Norman to Pacific, Pacific’s commercial bribery claim against Fidelity (an element of which is that a fiduciary commits an offense) also failed as a matter of law. The trial court granted summary judgment for Fidelity on the joint venture claim, and Pacific did not challenge that ruling. Pacific did argue, however, that the trial court erred in granting summary judgment because Fidelity failed to disprove the existence of a partnership between Norman and Pacific, which would have given rise to fiduciary duties. The court noted that a review of the record revealed that “Pacific did not plead partnership—rather, it pleaded only joint venture.” According to the court, “[b]ecause Pacific only pleaded joint venture as the basis for the fiduciary duty allegedly breached by Norman, Fidelity was not required to negate the existence of an unpled theory of partnership.” Pacific did subsequently add a partnership theory in its third amended petition, but it was filed after the trial court had granted

summary judgment for Fidelity. “Because Pacific did not allege partnership at any time prior to summary judgment, Fidelity had no burden to disprove the existence of a partnership.”

Pacific also argued that the trial court abused its discretion when it sustained Norman’s objections to Pacific’s summary judgment evidence. Pacific had attached various declarations to its summary judgment response that referenced a “partnership” between Pacific and Norman. The court found that the trial court did not abuse its discretion: “The trial court could have properly sustained Norman’s objections to the above statements because the statements presuppose that a partnership had already formed. ‘Mere legal conclusions cannot give rise to an issue of a disputed fact such as the existence of a partnership.’”

The court of appeals then discussed the partnership claim that Pacific added in its third amended petition. The court cited the factors indicating that persons have created a partnership from § 152.052(a) of the Business Organizations Code: “(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: (A) losses of the business; or (B) liability for claims by third parties against the business; and (5) agreement to contribute or contributing money or property to the business.” The court noted that “[a]n agreement to share losses by the owners of a business is not necessary to create a partnership,” and it stated that “[w]hile a court must consider all of the factors, conclusive evidence of only one factor is insufficient to prove the existence of a partnership.”

In discussing the sharing of profits, Pacific was to be the operator for Norman, and it would be paid as an operator with a 30% net profit interest. The court stated that “[w]hile it is true that the ‘receipt or right to receive a share of profits of the business’ may be indicative of the existence of a partnership, ‘a share of profits paid as wages or other compensation to an employee or independent contractor is not indicative of a partnership interest in the business.’”

With regard to the second factor, the court observed that the Texas Supreme Court has stated that there must be evidence that both parties expressed their intent to be partners. Pacific relied on a statement in a memorandum of understanding that the memorandum was “an expression of interest to enter into an operating agreement.” According to the court, “[t]his statement is not evidence of an intent to be partners in the business.” Pacific also argued that the declarations demonstrate that Norman expressed “an intent to be partners in the business, including discussions on the partnership’s structure and Norman’s acquiescence to the partnership.” The court disagreed: “The court in *Ingram* held that such colloquial references are legally insufficient expressions of intent; rather, the focus should be on statements to third parties or holding the other party out as partner. Pacific has not pointed to any statement by the Normans to a third party that the Normans considered themselves to be in a partnership with Pacific.”

In discussing the right of control, the court observed that “[c]ontrol of the business is one of the most important factors in determining whether a partnership has been formed,” and it stated that “[t]he right to control a business is the right to make executive decisions.” The court noted that “[a]s sole owner of the assets, Norman would have the exclusive right to make decisions about developing the oil and gas interests; Pacific as the prospective operator, would not have that right but, rather, only the rights granted to it under an operating agreement.” Further, “Pacific also acknowledged that Norman would handle all of the accounting for the business.” Thus, there was no evidence reflecting a mutual right to control the business.

With regard to loss sharing, Pacific argued in its summary judgment response that had the transaction reached the operating phase, “presumably Norman would absorb losses stemming from the Properties and Pacific would absorb losses stemming from the pipeline that served the Properties.” The court concluded that “Pacific’s contention about a presumptive agreement is not evidence of an agreement to share losses.” Moreover, “the [memorandum of understanding] makes no mention of loss sharing.”

Finally, with respect to contributions to the business, Pacific argued that “both Norman and Pacific contributed to the partnership: Norman provided the initial cash deposit and Pacific provided the APA (rights to purchase the Properties).” The court observed, however, that even if Pacific’s assignment of its rights under the APA raised a fact issue as to the existence of “an agreement to contribute . . . money or property to the business,” evidence of only one factor is insufficient to prove the existence of a partnership. As the court concluded: “Under the totality-of-the-circumstances test prescribed by *Ingram*, the record establishes as a matter of law the lack of the existence of a partnership between Pacific and Norman. . . . Having concluded that no partnership existed, Pacific’s claims for breach of fiduciary duty and commercial bribery based on the fiduciary relationship arising from a partnership likewise fail.”

***Tin Star Development, LLC v. 360 Residential, LLC***, No. 05-17-00040-CV, 2018 WL 1804891 (Tex. App.—Dallas Apr. 17, 2018, no pet.) (mem. op.).

The court affirmed a summary judgment against the plaintiff on its breach-of-fiduciary-duty claim because the plaintiff failed to raise a fact issue as to the existence of either a joint venture or an informal fiduciary relationship.

The plaintiff, Tin Star Development, LLC (“Tin Star”), sued 360 Residential, LLC (“360 Residential”), alleging various causes of action arising out of a dispute involving a real estate development. One of Tin Star’s claims was for breach of fiduciary duty, and the trial court granted 360 Residential’s motion for summary judgment against Tin Star on this claim.

Although 360 Residential challenged all three elements of Tin Star’s claim for breach of fiduciary duty—(1) a fiduciary relationship between the plaintiff and defendant, (2) breach of the fiduciary duty by the defendant, and (3) injury to the plaintiff or benefit to the defendant as result of the breach—the court of appeals only found it necessary to discuss the first element because Tin Star failed to raise a fact issue on the existence of a fiduciary relationship. Tin Star argued that there was evidence of a joint venture or an informal fiduciary relationship. The court stated that joint venturers owe each other fiduciary duties, and the court listed the elements of a joint venture as: (1) an express or implied agreement to engage in a joint venture, (2) a community of interest in the venture, (3) an agreement to share profits and losses from the enterprise, and (4) a mutual right of control or management of the enterprise. Although there was testimony that the parties contemplated a future joint venture, there was no testimony that a joint venture existed between Tin Star and 360 Residential. They did not agree, for example, to share profits and losses from an enterprise. Instead, Tin Star and 360 Residential each formed an LLC subsidiary, and those two LLCs entered into an LLC agreement with each other forming another LLC. Thus, there was no joint venture relationship between Tin Star and 360 Residential giving rise to a fiduciary relationship. Although Tin Star also alleged the existence of an informal fiduciary relationship based on its reliance on 360 Residential’s investment expertise, subjective trust between parties in an arms-length transaction does not transform a business relationship into a fiduciary relationship, and Tin Star failed to raise a fact issue as to the existence of an informal fiduciary relationship.

***Raybourne & Dean Consulting, Ltd. v. Metrica, Inc.***, Civil Action No. SA–14–CA–918–OLG, 2016 WL 7497587 (W.D. Tex. Feb. 19, 2016), report and recommendation adopted, 2016 WL 7496197 (W.D. Tex. Mar. 10, 2016), *aff’d*, 682 Fed. App’x 349 (5th Cir. 2017) (per curiam). (Although the court issued this opinion in 2016, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court held that the plaintiff failed to meet its summary-judgment burden to raise a fact issue as to one or more essential elements of its claims for breach of duty of good faith and fair dealing and breach of fiduciary duty in a dispute revolving around a Preferred Supplier Agreement for Provision of International Services entered into between the parties. The claim for breach of duty of good faith and fair dealing failed because neither the references to “good faith” in the agreement nor the nature of the relationship under the agreement (which the plaintiff contended was an agency relationship, but the court held was not) were sufficient to give rise to such a duty. With respect to the claim for breach of fiduciary duty, the plaintiff contended that the parties “entered into a joint venture Partnership Agreement which gave rise to the duties of loyalty, good faith and fair dealing, confidence, trust, information and disclosure and a duty of care” and that “Defendants wantonly, recklessly, maliciously, willfully and with conscious disregard breached their fiduciary duty to Plaintiff as a Partner.” The defendant argued that the plaintiff was an independent contractor under the agreement, and the court stated that the plaintiff made only conclusory allegations that the parties had a relationship of “trust.” The court concluded that even if the plaintiff demonstrated a fiduciary relationship, it failed to meet the second and third elements of a claim for breach of fiduciary duty (breach by the defendant and damage to the plaintiff).

***Bowgene Fluidics, Inc. v. Alfa Laval Dortmund GmbH***, Civ. A. No. H-11-2414, 2012 WL 13042501 (S.D. Tex. Mar. 22, 2012). (Although the court issued this opinion in 2012, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court granted a motion to dismiss on a breach-of-fiduciary-duty claim based on an alleged partnership.

Bowgene alleged that it entered into a partnership agreement with Anderson, an entity that Dortmund later acquired, and that Dortmund breached the fiduciary duty owed to Bowgene as partner. Dortmund countered that

Bowgene failed to plead facts showing the existence of a partnership under Texas law. The court agreed with Dortmund:

The Texas Business & Organizations Code sets forth five factors for determining 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) 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. TEXAS BUS. ORGS. CODE § 152.052(a)(2). In determining whether a partnership exists courts are required to evaluate the “totality-of-the-circumstances.” *Ingram v. Deere*, 288 S.W.3d 886, 898 (Tex. 2009). While proof of all of the enumerated factors is not required to establish the existence of a partnership, conclusive evidence of only one factor is generally insufficient to establish the existence of a partnership. Sharing profits and control over the business are probably the most important factors, although they are not required.

Bowgene alleges that Anderson expressed an intention to be partners based on a 2008 confidentiality agreement, which refers to Bowgene as “partner.” While this is some evidence of an intention to enter into a partnership, it falls short of being conclusive enough to support the existence of a partnership absent facts supporting the remaining factors. For example, the confidentiality agreement contemplates the parties discussing a “possible cooperation.” An agreement to discuss possible cooperation strongly suggests that Anderson had no intention of creating a partnership with Bowgene. Moreover, other than the few references to Bowgene as partner, the agreement deals exclusively with the confidentiality of information between Bowgene and Anderson and is specifically titled “confidentiality agreement.” Viewing the confidentiality agreement as a whole, the language implies that it was consummated solely for the purpose of maintaining confidentiality, not forming a partnership.

Bowgene also alleges that it contributed valuable property in the form of its goodwill and reputation to support its claim that a partnership existed. However, the facts pleaded in the complaint do not support this factor. For example, Bowgene cites [Gary] Fischer’s [the founder of Bowgene] widely respected reputation in the sanitary valve field as a key element of the formation of the Agreement. The mere fact that Fischer had a good reputation does not support the allegation that Bowgene actually contributed its reputation or goodwill. In yet another example, Bowgene alleges that “the parties worked together on various issues throughout 2008.” However, every business relationship inherently requires businesses to work together. Simply stated, none of Bowgene’s factual allegations supports this factor.

Moreover, Bowgene has not alleged facts supporting any of the three remaining factors, including shared control or profits, which are the two most important. With regard to the control factor, the Agreement specifically states “[n]either Bowgene or Anderson, or its employees or representatives may make commitments of any type that would be binding on the second party . . . without the express written consent of the second party.” Thus, the control factor clearly weighs against the existence of a partnership. Accordingly, the Court holds that, even taking every factual allegation plead by Bowgene as true, it is not plausible that a partnership existed.

## **B. Partnership by Estoppel**

*Lost Maples General Store, LLC v. Ascentium Capital, LLC*, No. 14-18-00215-CV, 2019 WL 1966671 (Tex. App.—Houston [14th Dist.] May 2, 2019, no pet. h.) (mem. op.).

In the absence of findings by the trial court on either of the two elements required for partnership by estoppel—(1) a representation that the one sought to be bound is a partner, and (2) reliance by the one to whom the representation is made—conclusive evidence was necessary to prevail on a claim of partnership by estoppel on appeal. Because the evidence was conflicting, the claim failed.

A lender sued the borrower on a loan made to finance the purchase of a product by the borrower. The seller had referred the borrower to the lender, and the borrower argued that the lender was estopped to deny that the lender and the seller were partners so that the seller’s failure to deliver the product amounted to a failure of consideration

that was a defense to payment of the loan. The trial court did not make findings on the elements of partnership by estoppel, but the borrower argued on appeal that the elements were conclusively established. The court of appeals described the elements as: (1) a representation that the one sought to be bound is a partner, and (2) reliance by the one to whom the representation is made. The appellate court described evidence that the lender and seller held each other out as partners by referring to a partnership in a vendor agreement between them and in press releases, but there was also conflicting evidence in the same agreement and by way of testimony that the press releases had not been authorized by the lender. The court discussed additional evidence that was conflicting or was not conclusive. Furthermore, the court pointed out that the borrower would have to show it used due diligence in ascertaining the truth, and there was evidence that the borrower had information showing that the lender and seller were not each other's agent. Thus, the claim of partnership by estoppel failed.

*Al-Saud v. Yootoo Media, L.P.*, 754 Fed. App'x 246 (5th Cir. 2018).

A general partner (Chris Wyatt) signed a letter of intent ("LOI") on behalf of himself and a limited partnership (Yootoo Media, L.P.) He later claimed that he was not the general partner listed on the registration documents filed with the state. As part of its analysis, the Fifth Circuit observed:

The other part of Wyatt's argument appears to be that derivative liability [the principle that a general partner is liable for the limited partnership's obligations] cannot hold when someone else is the legally registered general partner. But this is just another way to try and avoid the ban on extrinsic evidence. Although the core focus of the parol evidence rule is excluding the negotiation history of a contract, it also bars other extrinsic evidence such as government records that are inconsistent with the terms of the contract. To the extent the parties knew the identity of the actual General Partner but mistakenly listed Wyatt, a claim of mutual mistake was the way to correct this error.

Absent a claim of mutual mistake, there is nothing unusual about holding Wyatt to the agreement he signed. Indeed, a person could contractually agree to take on the legal obligations of a general partner, even if not legally registered as such. The contract here did just that. A different doctrine—partnership by estoppel—demonstrates the point that official documents do not always control. Under partnership by estoppel, a person who falsely represents herself as a member of a partnership can still be liable as if she were a partner. Just as failing to legally form a partnership will not always prevent the imposition of liability, failing to legally register as the general partner will not always do so either. And the reliance interests that underlie estoppel also support enforcing the contract the parties signed.

Of course, our holding might be different if Wyatt had no notice that the contract designated him General Partner. But Wyatt was on notice because he signed the LOI directly to the right of the words "Signed for and on behalf of: Chris Wyatt as the General Partner."

The contract says Wyatt was the General Partner. The parol evidence rule prevents Wyatt from now trying to change that. He thus is derivatively liable for . . . Youtoo's obligations under the contract.

### **C. Partner's Personal Liability**

*Tyson and Billy Architects, PC v. Kingdom Perspectives G.P., Ltd.*, Civil Action No. 6:19-CV-00053-JDK, 2019 WL 2127343 (E.D. Tex. Apr. 24, 2019).

The court held that the plaintiff stated a claim against the defendant for breach of contract and judicial foreclosure of a mechanic's and materialman's lien based on the plaintiff's allegations that the contract was with a partnership of which the defendant was a partner. The defendant argued that the contract was with an LLC and that the defendant was not liable absent veil-piercing allegations, but the plaintiff alleged that the LLC was not formed until five months after the contract was executed and that the LLC no longer existed. Taking the allegations as true, the court stated that the plaintiff stated claims against the defendant "[a]s an alleged partner to a contract for which judicial foreclosure is sought on a lien under the Texas Property Code," relying on the principle that "[a] partner in a general partnership is personally liable for partnership debts jointly and severally with all other partners."

***Pierce v. Fondren Orthopedic Group, LLP***, Civ. A. No. H-18-1686, 2018 WL 6200049 (S.D. Tex. Nov. 28, 2018).

The court denied (a) Peggy Pierce’s and Fondren Orthopedic, Ltd.’s (“FOLTD”) cross-motions for summary judgment on a breach-of-contract claim, and (b) Snow Goose Corporation’s motion to intervene.

FOLTD was a Texas limited partnership formed for the purpose of investing in a hospital. The general partner of FOLTD was Snow Goose Corporation. In the breach-of-contract claim before the court, Pierce alleged that FOLTD had breached an agreement which allegedly obligated it to pay Pierce for five years after her termination from a FOLTD affiliate. The agreement was signed by Dr. G. William Woods, M.D. in his capacity as the President of Snow Goose.

The court concluded that the agreement was supported by consideration and did not excuse FOLTD’s performance in the event of a for-cause termination. The court then engaged in a lengthy discussion of whether Woods had actual or apparent authority to act on behalf of Snow Goose. FOLTD argued in part that Woods lacked actual authority to enter into the agreement because Pierce was an officer of Snow Goose, and the Snow Goose bylaws apparently required contracts between Snow Goose and Snow Goose officers to be approved by the Snow Goose board of directors. The court rejected the argument:

Plaintiff argues that her status as a Snow Goose officer is irrelevant to the enforceability of the Agreement because the Agreement was executed between Plaintiff and FOLTD, not Plaintiff and Snow Goose. The court agrees. The Agreement is between Plaintiff and FOLTD and has nothing to do with Plaintiff’s involvement in the management of Snow Goose. The court is therefore not persuaded by Defendants’ arguments that the Agreement required approval of the Snow Goose Board because of Plaintiff’s alleged status as an officer of Snow Goose.

The court is also not persuaded by Defendants’ argument that because Snow Goose is FOLTD’s general partner, all FOLTD contracts are necessarily Snow Goose contracts. In its Cross-[Motion for Partial Summary Judgment], FOLTD cites *Peterson Group, Inc. v. PLTQ Lotus Group, L.P.*, 417 S.W.3d 46 (Tex. App.—Houston [1st Dist.] 2013, pet. denied), and *Pinebrook Properties, Ltd. v. Brookhaven Lake Property Owners Ass’n*, 77 S.W.3d 487 (Tex. App.—Texarkana 2002, pet. denied), in support of its argument that Texas law considers limited partnerships to be “one and the same” with their general partners. These cases merely held that the doctrine of alter ego does not apply to the general partners of limited partnerships because there is no need to “veil pierce” in order to hold general partners liable—general partners are already jointly and severally liable on partnership obligations. *Peterson Group*, 417 S.W.3d at 57; *Pinebrook Properties*, 77 S.W.3d at 499-500. The fact that Snow Goose could ultimately be held liable on one of FOLTD’s obligations does not mean that Snow Goose was a party to all of FOLTD’s contracts. The Agreement was between Plaintiff and FOLTD; it did not purport to create a Snow Goose obligation. The Agreement did not need to conform to the requirements of the Snow Goose Bylaws or Texas law regarding contracts between corporate officers and corporations.

The court ultimately determined, however, that fact questions on actual and apparent authority precluded the grant of summary judgment for any of the parties.

In rejecting Snow Goose’s motion to intervene, the court stated that “[m]erely because Snow Goose was FOLTD’s general partner and Snow Goose acted as FOLTD’s signatory does not make Snow Goose a party to the Agreement.” The court concluded that the interests of Snow Goose were adequately represented by FOLTD because the agreement was between Pierce and FOLTD.

***Al-Saud v. Yootoo Media, L.P.***, 754 Fed. App’x 246 (5th Cir. 2018).

The Fifth Circuit affirmed the district court’s judgment of liability for breach of contract and attorney’s fees against a general partner of a limited partnership. The court also affirmed the dismissal of the limited partnership’s counterclaims on the grounds that the damages sought were too speculative.

Mansour Bin Abdullah Al-Saud made a \$3 million reimbursable down payment to Yootoo Media, L.P. while he considered whether to purchase a stake in the technology company. The parties signed a letter of intent (“LOI”) memorializing that Al-Saud would provide \$3 million to Yootoo and that he had three months to decide

“in his sole discretion” whether to buy a stake in the company. If he declined to invest, Youtoo would reimburse the down payment. The LOI also created Youtoo Middle East, a joint venture that would market the company’s interactive platform in the region.

The LOI provided that Youtoo’s “general partner is Chris Wyatt (the ‘General Partner’).” Further, Wyatt signed the agreement on behalf of both Youtoo and “Chris Wyatt as the General Partner.” Registration documents filed with the Texas Secretary of State, however, indicated that Youtoo Management, LLC (not Wyatt individually) was the general partner of Youtoo.

Al-Saud ultimately declined to purchase an interest in the company. Youtoo’s primary lender eventually forced the company to sell its intellectual property and assets to cover outstanding debts. In light of Youtoo’s wind down, Al-Saud asked for his money back. Youtoo rejected his request and asserted that Al-Saud had agreed to be “reimbursed in full” through the first \$3 million in profit distributions from Youtoo’s share in the Middle East entity.

Al-Saud sued for breach of contract. Youtoo counterclaimed for breach of contract, breach of fiduciary duty, and fraud. At trial, the district court dismissed Youtoo’s counterclaims as a matter of law. The jury then found Youtoo and Wyatt liable for breaching the LOI and awarded Al-Saud \$3 million in damages for the down payment that was not returned. Al-Saud was also awarded attorney’s fees against Wyatt but not Youtoo.

Youtoo did not appeal the breach-of-contract judgment against it. Wyatt appealed the judgment against him, however, arguing that the LOI did not make him directly liable for the down payment. He further argued that he could not be derivatively liable as Youtoo’s general partner because the LOI was mistaken in saying that he held that position.

The court noted that whether Wyatt could be directly liable under the LOI was a matter of contract interpretation that could be reviewed *de novo*. The court concluded that, although the LOI did specify some obligations of the general partner, the LOI placed the burden of reimbursing Al-Saud’s down payment on Youtoo alone. The court noted that Wyatt’s signature on the LOI did not alter its conclusion, as Wyatt signed only in a representative capacity:

He signed “[f]or and on behalf of: YOUTOO MEDIA, L.P.,” much like a CEO might sign a contract on behalf of the corporation. And as long as the CEO makes clear that she is only signing as a representative of the corporation, then she is not directly liable. That is the situation here. Wyatt signed for Youtoo in a representative capacity. His second signature on behalf of himself as General Partner makes him liable for that [entity’s] obligations. But as we have explained, the reimbursement provision only attaches to Youtoo.

Even though Wyatt was not directly liable for the reimbursement obligation under the LOI, the court observed that Youtoo was liable for the obligation. Because “the general partner in a limited partnership is liable for the debts and obligations of the partnership,” the court stated that “even if Wyatt was not independently liable for the down payment, we will consider whether this principle of derivative liability provides an alternative basis for affirming the judgment.” Wyatt argued that he was not the general partner, and he sought to submit extrinsic evidence in support. The court discussed the restraints of the parol evidence rule and noted that Wyatt had not timely raised a mutual mistake exception. As a result, Wyatt needed to show that the parol evidence rule was inapplicable.

Wyatt first argued that partner derivative liability is imposed by law and not by contract. He asserted that because the state-filed partnership records go to a matter of law and not to the interpretation of the LOI, they are admissible. The court rejected the argument:

The divide Wyatt tries to establish between liability that arises from contract (no parol evidence) and that arising from law (parol evidence allowed) proves too much. The enforcement of any contractual term depends on the application of “law.” So if the parol evidence rule went by the wayside anytime legal principles are being applied, there would be little if anything left of the rule.

Among the many background legal principles against which parties negotiate is derivative liability for general partners. When a contract describes a limited partner-general partner relationship, it assumes a derivative liability arrangement. A counterparty who deals with a limited

partner takes into account the financial status of the general partner when determining the terms it will accept. Without the general partner, the terms of the contract might be different. And a limited partner and counterparty have the ability to alter the contract to eliminate derivative liability. See TEXAS BUS. ORGS. CODE § 152.304(a)(1) (allowing partners and claimants to agree to modify default rule for general partnership liability); § 153.003(a) (making section 152.304(a)(1) applicable to limited partnerships). The contract's listing of Wyatt as General Partner carried the default rule of derivative liability with the designation. As opposed to being some purely external force, derivative liability of a general partner is as much a part of the contract as other types of liability. It is the contract and not the operation of law acting in isolation that imposes the obligations of a general partner. As a result, Wyatt's purported contract/law distinction fails to avoid the ordinary rule that external documents cannot prevent enforcement of what the parties agreed to in writing.

Wyatt also argued that derivative liability could not be imposed on someone who is not, in fact, the legally registered general partner. The court rejected this argument as well:

The other part of Wyatt's argument appears to be that derivative liability cannot hold when someone else is the legally registered general partner. But this is just another way to try and avoid the ban on extrinsic evidence. Although the core focus of the parol evidence rule is excluding the negotiation history of a contract, it also bars other extrinsic evidence such as government records that are inconsistent with the terms of the contract. To the extent the parties knew the identity of the actual General Partner but mistakenly listed Wyatt, a claim of mutual mistake was the way to correct this error.

Absent a claim of mutual mistake, there is nothing unusual about holding Wyatt to the agreement he signed. Indeed, a person could contractually agree to take on the legal obligations of a general partner, even if not legally registered as such. The contract here did just that. A different doctrine—partnership by estoppel—demonstrates the point that official documents do not always control. Under partnership by estoppel, a person who falsely represents herself as a member of a partnership can still be liable as if she were a partner. Just as failing to legally form a partnership will not always prevent the imposition of liability, failing to legally register as the general partner will not always do so either. And the reliance interests that underlie estoppel also support enforcing the contract the parties signed.

Of course, our holding might be different if Wyatt had no notice that the contract designated him General Partner. But Wyatt was on notice because he signed the LOI directly to the right of the words "Signed for and on behalf of: Chris Wyatt as the General Partner."

The contract says Wyatt was the General Partner. The parol evidence rule prevents Wyatt from now trying to change that. He thus is derivatively liable for . . . Youtoo's obligations under the contract.

Because the Fifth Circuit upheld the liability finding as to Wyatt, it also needed to decide whether the district court erred in awarding attorneys' fees against Wyatt. The court noted that under § 38.001 of the Texas Civil Practice and Remedies Code, a party prevailing on a breach-of-contract claim may recover fees from an individual or corporation. Because "[c]ourts have interpreted 'individual' and 'corporation' strictly," the court concluded that "partnerships like Youtoo are not liable for fees." With respect to Wyatt, the court observed that "[i]t might seem anomalous if Wyatt were on the hook for fees when the party with the underlying liability is not," and it noted that "Texas courts have not addressed this situation." Nevertheless, the Fifth Circuit concluded that the text of § 38.001 was clear and "[i]t does not make the recovery of such fees dependent on the theory of liability imposed." As the court observed: "[Section 38.001] looks solely to whether that party is an individual or corporation. Whether Wyatt is derivatively or directly liable, he is still an individual. We will therefore affirm the judgment requiring Wyatt to pay fees for the breach of the LOI."

Youtoo's counterclaims alleged that Al-Saud had breached the LOI and his fiduciary duties by failing to manage Youtoo Middle East's operations and by fraudulently inducing Youtoo to sign the LOI. The district court rejected the counterclaims on the ground that the testimony of Youtoo's damages expert was too speculative. The



Fifth Circuit agreed that the evidence of lost profits was speculative and that the trial court did not abuse its discretion in excluding the evidence and dismissing the counterclaims.

*Westergren v. Houston Pilots Association*, 566 S.W.3d 7 (Tex. App.—Houston [14th Dist.] Aug. 7, 2018, no pet.) (“Yet, even if Houston Pilots were a general partnership, each individual partner pilot would be jointly and severally liable for a judgment against the partnership. In general, ‘all partners are jointly and severally liable for all obligations of the partnership.’ Tex. Bus. Orgs. Code § 152.304(a). ‘This personal liability, undoubtedly a[ ] . . . feature [of the aggregate theory of partnership], is a defining characteristic of the partnership form and distinguishes it from other entity types.’ *Am. Star Energy*, 457 S.W.3d at 429. In addition, a judgment creditor of a general partnership can immediately enforce that judgment by execution against the joint property of the partners and, in some circumstances, can also execute against the individual property of partners without first seeking satisfaction from partnership property. *Id.* at 429-430 & n.2; see Tex. Bus. Orgs. Code §§ 152.306(b)-(c). [As with an unincorporated association, a judgment creditor of a partnership cannot execute against the individual property of partners without serving them. Tex. Bus. Orgs. Code § 152.306(a). But the judgment against the partnership generally is conclusive of the individual partners’ joint and several liability. *Id.* § 152.304(a).]”).

*Architettura, Inc. v. DSGN Associates, Inc.*, Civ. A. No. 3:16-CV-3021-S, 2018 WL 3575877 (N.D. Tex. July 25, 2018).

The court granted a motion to dismiss on the grounds that limited partners were not liable for alleged copyright infringement.

McKinney Millennium, LP was a limited partnership. BCP/McKinney Millennium, LLC (“BCP”) and BCCC, Inc. (“BCCC”) were limited partners in McKinney Millennium. BCP and BCCC were sued by Architettura for direct and vicarious copyright infringement claims. BCP and BCCC moved to dismiss, arguing that Architettura could not state copyright infringement claims against them based solely on their status as limited partners. The district court agreed:

Architettura alleges that BCP and BCCC, as limited partners of McKinney Millennium, LP, are liable for direct and vicarious copyright infringement. As limited partners, however, BCP and BCCC generally are not liable for the obligations of the limited partnership. Under Texas law, a limited partner is only liable for the obligations of a limited partnership if the limited partner is also a general partner or if the limited partner participates in the control of the business. TEX. BUS. ORGS. CODE ANN. § 153.102(a). Even if the limited partner participates in the control of the business, however, that partner is only liable to “persons who transact business with the limited partnership reasonably believing, based on the limited partner’s conduct, that the limited partner is a general partner.”

In the Third Amended Complaint (the “Complaint”), Architettura does not assert that BCP and BCCC were directly involved in any of the allegedly infringing activities. In fact, Architettura only references BCP and BCCC twice in the entire Complaint. First, Architettura includes the entities in the list of parties. Second, Architettura notes that BCP and BCCC are partners of McKinney Millennium, LP.

In what appears to be an attempt to overcome the Complaint’s lack of substantive allegations regarding BCP and BCCC, Architettura alleges for the first time in its response to the Supplemental Motion that BCP and BCCC are limited partners in name only. Architettura argues that, as “Investment Limited Partner” and “Special Limited Partner,” BCP and BCCC have “extensive control and the right to approve or disapprove of the operations of [McKinney Millennium, LP].” These assertions are clearly rebutted by the McKinney Millennium, LP Partnership Agreement. The agreement notes: “[T]he Limited Partners shall not participate in the operation, management or control of the Partnership’s business.” It further states that the General Partner “shall exercise full and exclusive control over the affairs of the Partnership.”

The only limitations on this control are found in Section 5.3, which requires BCCC, as Special Limited Partner, to consent before the General Partner takes actions such as contravening the partnership agreement, instituting a legal action, or commingling partnership funds. In Texas, a limited partner does not participate in the control of the business just because it “possesses or

exercises” the power to “propos[e], approv[e], or disapprov[e] . . . any . . . matter stated in the partnership agreement.” TEX. BUS. ORGS. CODE ANN. § 153.103. Thus, the Court finds that BCP and BCCC did not participate in the control of McKinney Millennium, LP for liability purposes.

Regardless of whether BCP and BCCC participated in the control of the business, Architettura has wholly failed to show, or even argue, that it transacted business with the entities under the belief that they were general partners. Therefore, BCP and BCCC, in their roles as limited partners of McKinney Millennium, LP, are not liable to Architettura.

The court also noted that the infringements listed by Architettura in the Complaint occurred between 2011 and 2013, while BCP and BCCC did not become limited partners of McKinney Millennium until March 28, 2014. Thus, BCP and BCCC could not have directly infringed any of Architettura’s copyrights between 2011 and 2013. In addition, they could not have vicariously infringed any copyrights because they had neither a right to control nor a direct financial interest in McKinney Millennium’s activities at that time. Architettura contended that it only listed the dates of which it was currently aware and that “[s]ome of the infringements of the McKinney Millennium protected works occurred after the Fall of 2013.” The court observed, however, that the Complaint did not provide evidence of any infringements occurring on or after March 28, 2014. As a result, it failed to “raise [Architettura’s] right to relief above the speculative level.”

*Lakes of Rosehill Homeowners Association, Inc. v. Jones*, 552 S.W.3d 414 (Tex. App.—Houston [14th Dist.] 2018, no pet.) (“This recognition that Chapter 33 does not supersede a common-law rule of joint and several liability is not unique to the *Landers* rule. As this Court and others have held, ‘[c]ommon-law joint-and-several-liability rules for partnership, agency, joint venture, and piercing the corporate veil situations survived the enactment of § 33.013 of the Texas Civil Practice and Remedies Code [the proportionate responsibility statute].’”).

*Malletier v. Texas International Partnership*, Civ. A. H-10-2821, 2011 WL 13253847 (S.D. Tex. Nov. 18, 2011). (Although the court issued this opinion in 2011, it is included in this year’s update because it did not appear in the Westlaw database until recently.) (“Under Texas law, a ‘limited partnership’ is ‘a partnership that is governed as a limited partnership under Title 4’ of the Texas Business Organizations Code ‘and that has one or more general partners and one or more limited partners.’ Tex. Bus. Org. Code Ann. § 1.002(50). ‘General partners of a limited partnership are personally liable to creditors for the limited partnership’s debts the same as a partner in a general partnership.’ ‘Under general partnership law, all partners are jointly and severally liable for all debts and obligations of the partnership.’”).

*Wilson v. United States*, No. A-11-CA-221-SS, 2011 WL 13324270 (W.D. Tex. Oct. 12, 2011). (Although the court issued this opinion in 2011, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court determined that the plaintiffs’ claims against the Army were barred by sovereign immunity because they did not meet their burden to show an employer relationship between the limited partner and general partner.

Pursuant to the Military Housing Privatization Initiative, housing at Fort Hood was owned and administered by a private entity, Fort Hood Family Housing LP (“FHFH”). Actus Lend Lease (“Actus”) was the general partner of FHFH and in charge of conducting FHFH’s business. The Army was a limited partner.

Darlene and Trevor Wilson claimed that they suffered personal injuries and property damages from exposure to mold while stationed at Fort Hood and living in on-base housing. The Wilsons asserted that the Army and Actus were both negligent in maintaining the housing unit, any breach by Actus could be imputed to the Army under the doctrine of respondeat superior, and the Army was negligent in delegating on-base housing responsibilities to FHFH and Actus.

The court granted the Army’s motion to dismiss those claims against it for lack of subject matter jurisdiction. The Army argued, and the court agreed, that the Army was immune from this suit as a sovereign and the Federal Tort Claims Act (“FTCA”) did not waive immunity because both the independent contractor exception and the discretionary function exception applied.

The court began its analysis with the fundamental principle that the United States, as sovereign, is immune from suit unless it has consented to be sued or otherwise waived immunity. The FTCA is such a consent and waives immunity in certain instances. If an exception to the FTCA applies, however, then sovereign immunity is not waived. Specifically, the FTCA embodies a consent to sue the government for acts or omissions committed by an “employee of the Government while acting within the scope of [their] office or employment,” but this waiver does not include independent contractors. 28 U.S.C. §§ 1346(b)(1), 2671. The Army first argued that the independent contractor exception applied to the Wilsons’ claims because Actus was an independent contractor. The court observed that the critical factor in determining status as an employee or independent contractor was the Army’s power to control the physical performance of Actus. In the absence of control, the traditional principles of agency law apply, which are enumerated as ten factors in § 220 of the Restatement (Second) of Agency. The court determined that the Army did not exercise control over Actus or FHFH because the partnership agreement was clear that the Army, as a limited partner, had no power over day-to-day decisions. Further, other “major decisions,” such as large-dollar or unusual expenditures, appeared to be a shared decision-making process. A majority of the other relevant Restatement factors also supported the court’s determination that Actus was an independent contractor. Actus was engaged in a “distinct occupation or business,” namely building and managing over 6,000 commercial-style residential units which presumably required considerable institutional skill. Furthermore, FHFH and Actus supplied the “instrumentalities” of that work. The court observed that providing these residences was not the “regular business” of the Army, noting that even if it was previously, it was not now because that was Congress’s very purpose in allowing privatization of military housing. Finally, the court found that the evidence demonstrated the parties believed they were forging a partnership, not “creating an employer-employee relationship.” As a result, the court concluded that the independent contractor exception applied to the Wilsons’ claims against the Army and that sovereign immunity thus was not waived.

The Army then argued that the discretionary function exception also applied to the Wilsons’ claims. The court noted that the FTCA does not apply to “discretionary” acts, functions, or duties of government agencies. 28 U.S.C. § 2680(a). In order for the exception to apply, governmental actions and decisions must involve judgment and choice and be based on considerations of public policy. On the other hand, the discretionary function exception does not apply when a federal statute, regulation, or policy prescribes a specific course of conduct. The Wilsons argued that the Army was negligent in delegating management of on-base housing to Actus. The court disagreed, pointing out that the decision to delegate to a particular contractor generally falls within the discretionary function exception. The court determined that this decision was a discretionary policy function that was not mandated by a particular statute. The court reasoned that the statutory authorization for privatized on-base housing was permissive, not compulsory. Therefore, the court concluded that sovereign immunity was not waived because the discretionary function exception also applied to the Wilsons’ claims against the Army.

***PGEO Bioproducts SDN BHD v. National Biofuels LP***, Civ. A. H-07-3443, 2009 WL 10695136 (S.D. Tex. July 30, 2009). (Although the court issued this opinion in 2009, it is included in this year’s update because it did not appear in the Westlaw database until recently.) (“Plaintiff seeks to hold National Biofuels LLC, the general partner of National Biofuels LP, jointly and severally liable for the arbitration award. National Biofuels LP is a limited partnership organized under the laws of Texas. In Texas, ‘the general partner is always liable for the debts and obligations of the partnership.’ *Asshauer v. Wells Fargo Foothill*, 263 S.W.3d 468, 474 (Tex. App.—Dallas 2008, no pet.). Therefore, National Biofuels LLC is jointly and severally liable for the arbitration award rendered against National Biofuels LP.”).

***Crane v. Samson Resources Company***, Civ. A. No. B-07-064, 2008 WL 11394372 (S.D. Tex. Nov. 26, 2008). (Although the court issued this opinion in 2008, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court denied a contractual claim against a partner when a judgment against the partnership had apparently not been obtained.

Margot Eldridge and Kimme LaVergne (the “Lessors”) entered into oil and gas leases with Samson Lone Star Limited Partnership (“SLS”). Defendant Samson Resources Company (“Samson Resources”) was the general partner of SLS. The Lessors assigned any claim they had against SLS for breach of contract to plaintiffs Randall and Toni Crane.

Phillip Schmucker, a vice president of Samson Resources, signed the oil and gas leases on behalf of SLS. The Cranes asserted that based on this signature, Samson Resources must be held liable for the obligations set out in the lease. The court discussed Texas law related to a creditor's ability to pursue a general partner before attempting to exhaust the partnership's assets:

In Texas, a partnership is an entity legally distinct from its partners for most purposes. The Texas Revised Partnership Act states that "an action may be brought against a partnership and any or all of the partners in the same action or in separate actions." Tex. Civ. St. Art. § 6132b-3.05(b). "A judgment against a partnership is not by itself a judgment against a partner," but a plaintiff may seek judgment against a partner who has been served with process "in a suit against the partnership." *Id.* § 6132b-3.05(c). A creditor may proceed to "satisfy a claim that could have been successfully asserted against the partnership only if: (1) a judgment is also obtained against the partner; and (2) a judgment based on the same claim is obtained against the partnership that . . . remains unsatisfied for 90 days after: (i) the date of entry of the judgment; or (ii) the date of expiration or termination of the [stay], if the judgment is contested by appropriate proceedings and execution on the judgment has been stayed." *Id.* § 6132b-3.05(d); *but see Reagan v. Lyberger*, 156 S.W.3d 925, 929 (Tex. App.—Dallas 2005, no pet.) (permitting claim against individual partner without first suing partnership, where partnership was implied from the actions of the two implied partners). The language of § 6132-[3.05](d) indicates an intent to require an exhaustion of the partnership's resources before satisfying judgment against a partner, further evinced [by] a requirement that the partnership must be sued before or alongside a suit against the partner.

In addition, § 6132-3.05(e), entitled "Creditor's Direct Pursuit of Partner's Property," states:

[§ 6132-3.05(d)] does not prohibit a creditor from proceeding directly against one or more partners or their property without first seeking satisfaction from partnership property if:

- (1) the partnership is a debtor in bankruptcy;
- (2) the creditor and the partnership agreed that the creditor is not required to comply with [§ 6132-3.05(d)];
- (3) a court orders otherwise, based on a finding that partnership property subject to execution within the state is clearly insufficient to satisfy the judgment or that compliance with [§ 6132-3.05(d)] is excessively burdensome; or
- (4) liability is imposed on the partner by law independently of the person's status as a partner.

The court noted that the complaint only asserted contractual liability against Samson Resources based on its status as general partner of SLS. The Cranes did not assert any independent claim of contractual liability against Samson Resources. As the court concluded:

The Cranes have not otherwise demonstrated that [their] claims against the Defendant fall into one of the four possible actions against a general partner in its capacity as general partner. There is no prior judgment against SLS on which the Defendant can be found liable. There is no simultaneous action against SLS on the contract claim. The Cranes have not alleged that SLS is in bankruptcy or has clearly insufficient assets, nor have the Cranes asserted that an agreement existed between them and SLS permitting suit directly against the partners of SLS. The Cranes therefore have not provided any evidence to support a claim directly against the Defendant . . . .

***Quilling v. Erwin & Johnson, LLP***, No. 3:07-CV-1153-P, 2008 WL 11425340 (N.D. Tex. Feb. 25, 2008). (Although the court issued this opinion in 2008, it is included in this year's update because it did not appear in the Westlaw database until recently.) ("No limited liability partnership law in any state extends so far as to shield a partner from his own wrongful conduct.").

***Sharif v. Wellness International Network, Ltd.***, Civ. A. No. 3:05-CV-01367-B, 2007 WL 9711726 (N.D. Tex. May 9, 2007). (Although the court issued this opinion in 2007, it is included in this year's update because it

did not appear in the Westlaw database until recently.) (“Under Texas law general partners are jointly and severally liable with the limited partnership for the obligations of the partnership.”).

#### **D. Authority and Power of Partner to Bind Partnership**

*In re Luecke*, 569 S.W.3d 313 (Tex. App.—Austin 2019, mand. denied).

The court of appeals held that the trial court abused its discretion in granting the general partner’s motion to disqualify a limited partner’s attorney. The court rejected the general partner’s argument that a limited partner, as a matter of law, cannot waive a conflict of interest on behalf of the limited partnership.

Jimmie and Dorothy Luecke, the parents of Fred and Susan, divorced in 1987 and eventually entered into a settlement agreement that led to the creation of Jimmie Luecke Children Partnership, Ltd. (“Children One”) and Jimmie Luecke Children Partnership II, Ltd. (“Children Two”). The settlement agreement obligated Jimmie to place certain assets into Children One and Children Two (collectively, the “Children Partnerships”). The Children Partnerships had a similar structure, such that Jimmie was the sole general partner, and Jimmie, Fred, and Susan were the three limited partners.

In the derivative litigation underlying this mandamus action, Fred alleged that Jimmie mishandled a tract of land (the “Tract”) prospectively belonging to Children One. The Tract was conveyed to Jimmie while he was still married to Dorothy. In 2014, the grantor’s successor, the Bennie C. Jaehne 2010 Trust (“Jaehne”), sued Jimmie in a separate lawsuit. According to the petition in that suit, Jimmie owned a mineral interest in the Tract and was a trustee for Jaehne’s reserved mineral interest in the Tract. Fred sued Jimmie in 2016, alleging that Jimmie impermissibly gave away assets that rightfully belonged to Children One by failing to disclose an interest in the Tract. Fred’s petition further stated that after he raised this mishandling issue, Jimmie deeded the Tract to Children One and conveyed revenues produced from the Tract to Children One. Each version of Fred’s petition disclosed that Fred’s attorney was the same attorney who had filed the ongoing suit on behalf of Jaehne. In 2017, Fred signed an “affidavit waiving conflict of interest” that included a reaffirmation of his attorney’s representation in actions that result from being a limited partner of Children One.

After recognizing the potential conflict of interest that Fred’s attorney might have by representing Fred and Jaehne in separate suits relating to Jimmie’s alleged mishandling of the Tract, counsel for the Children Partnerships (as nominal defendants) filed a motion to disqualify Fred’s attorney. The motion asserted that: (1) there was a “clear and actual” conflict of interest between Children One and Jaehne with regard to the Tract; (2) Fred, on behalf of Children One, had neither the right to decide which claims to pursue nor waive a conflict of interest; and (3) Fred’s attorney did not have such a waiver from an authorized representative of Children One, which he would need in order to pursue derivative claims on its behalf given this conflict. Counsel for the nominal defendants acknowledged Fred’s waiver but contended that it was ineffective because only Jimmie, as the sole general partner, could waive a conflict on behalf of Children One.

The district court granted the motion to disqualify and Fred sought mandamus relief. Mandamus is the appropriate method to correct a trial court’s erroneous order disqualifying counsel because there is no adequate remedy by appeal. The applicable standard of review applied by the court of appeals was for abuse of discretion.

The issue before the court of appeals was whether the nominal defendants, as movants, met their burden of establishing the propriety of disqualification. Fred argued that no evidence was presented to support disqualification, while the nominal defendants argued that there was a conflict of interest that had not been waived under Rule 1.06 of the Texas Disciplinary Rules of Professional Conduct (the “TDRPC”).

The court of appeals began its analysis with the observation that disqualification is a “severe remedy” because it can result in immediate and palpable harm, disrupt proceedings, and deprive a party of the right to choose counsel. The court cited case law for the proposition that because the TDRPC serve as “guidelines—not controlling standards” for disqualification motions, the movant must demonstrate more than the violation of a disciplinary rule but that the “opposing lawyer’s conduct caused actual prejudice that requires disqualification.”

Rule 1.06 is the general rule governing conflicts of interest, which prohibits contemporaneous representation in “substantially related matter[s]” of clients whose interests are “materially and directly adverse.” TDRPC 1.06(b). However, Rule 1.06(c) permits such representation if (1) the attorney reasonably believes the representation of each client will not be materially affected; and (2) each affected or potentially affected client provides informed consent after full disclosure of the common representation. TDRPC 1.06(c).

The court cited Subchapter I of Chapter 153 of the Texas Business Organizations Code (Sections 153.401 through 153.405), which authorizes and governs derivative actions brought by a limited partner on behalf of limited partnerships.

According to the record before the court of appeals: (1) the allegations of mishandling the Tract involved *only* Children One and not Children Two; (2) Children One and Jaehne were each suing Jimmie to recover proceeds from mineral rights on the Tract; and (3) the nominal defendants agreed that Fred and Jaehne each provided conflict waivers to Fred's attorney. In support of their argument that the conflict of interest remained, the nominal defendants asserted that Fred's waiver should be disregarded because Fred, as a matter of law, could not waive the conflict of interest on behalf of Children One. The court rejected this argument for two reasons. First, the court observed that Fred was a limited partner and had the statutory authority to bring a suit derivatively on behalf of Children One before concluding that the right to bring an action and choose an attorney included the right to waive a conflict of interest for purposes of the derivative action.

Second, the court noted that the record showed that the claimed conflict of interest between Children One and Jaehne was *not yet* an actual conflict. The court pointed out that the objective of Fred's suit was a determination of what Jimmie owned at the time the settlement agreement was reached, as those assets should have been considered for inclusion in the settlement agreement for the benefit of the limited partners. Because Fred's suit did not appear to seek to recover from Jimmie the mineral interest reserved by Jaehne, the court reasoned that Fred's claims against Jimmie were not necessarily inconsistent with Jaehne's claims. Therefore, the court determined that the nominal defendants had alleged possible prejudice and not actual prejudice that required disqualification.

The court of appeals concluded that instead of meeting their burden of establishing that disqualification was proper, the nominal defendants provided (1) an unsupported argument that a limited partner, unquestionably permitted by statute to bring a derivative claim on behalf of a partnership, had no right to waive a conflict of interest and (2) allegations of possible prejudice. As a result, the court held that the district court abused its discretion in granting the motion to disqualify Fred's attorney. Thus, the court of appeals conditionally granted mandamus relief and ordered the district court to vacate its order granting the motion to disqualify counsel.

***Graves v. Lone Star NGL Pipeline LP***, No. 09-18-00173-CV, 2019 WL 962544 (Tex. App.—Beaumont Feb. 28, 2019, no pet. h.) (mem. op.).

The court of appeals affirmed the trial court's summary judgment in favor of a limited partnership seeking to exercise the power of eminent domain. The court held that authority to make the requisite declaration of necessity had been properly delegated to the CEO of the LLC that was the sole member of the general partner of the limited partnership.

Lone Star NGL Pipeline LP ("Lone Star") planned to construct a natural gas pipeline that would run through Liberty County, and the route was determined after an engineering and design study. A map of the route was attached to a Consent of Member in Lieu of a Meeting (the "Consent") signed by Kelcy Warren. Warren was the CEO of Lone Star NGL Asset Holdings II LLC (the "Company"), and the Company was the sole member of Lone Star NGL Asset GP LLC ("Lone Star GP LLC"), the sole general partner of Lone Star. The Consent outlined the relationship of the various Lone Star entities and stated that the Company, as the sole member of the general partner of Lone Star, found and determined "that public convenience, public use and necessity require that it is in the public interest" for Lone Star to acquire the land along the route. Certain landowners were unhappy with the proposed route, which traveled diagonally through their property, and Lone Star began condemnation proceedings after negotiations for an adjustment of the route failed. The landowners sought dismissal of the proceedings, arguing that Lone Star failed to establish necessity because the Consent was not executed by someone with authority to do so. The trial court denied the landowners' plea to the jurisdiction and motion to dismiss and granted a partial summary judgment in favor of Lone Star pursuant to which the only remaining issue for determination was the amount of just compensation due to the landowners. The landowners appealed.

The landowners challenged the validity of the determination of necessity by contending that Lone Star "presented no evidence that its governing body either determined necessity or delegated authority to exercise eminent domain." The landowners' attack focused on Warren's authority to sign the Consent and the relationship of the various Lone Star entities and their predecessors. The court noted that "a corporation, general partnership, limited partnership, limited liability company, or *other combination of those entities* engaged as a common carrier in the pipeline business for the purpose of transporting oil, oil products, gas . . . or other mineral solutions has all the rights and powers conferred on a common carrier by Sections 111.019-111.022, Natural Resources Code." Tex.

Bus. Orgs. Code Ann. § 2.105. (emphasis added by court). Section 111.019(b) of the Texas Natural Resources Code provides that in exercising the power of eminent domain, common carriers “may enter on and condemn the land, rights-of-way, easements, and property of any person or corporation necessary for the construction, maintenance, or operation of the common carrier pipeline.” The court stated that necessity is presumed from a determination by the condemnor unless a statute requires affirmative pleading and proof. A condemnor has the burden to show that the board of directors or other governing body or authority with power to speak made a determination of necessity, and this showing may be made through a board resolution or other evidence.

The court quoted at length from the Consent, including multiple recitals and resolutions in which the Company (in its capacity as the sole member of Lone Star GP LLC, acting general partner of Lone Star) determined the public necessity of acquiring the landowners’ property.

The landowners complained that Lone Star did not produce corporate documents relating to the authority or structure of the entities in support of the summary judgment but instead produced the affidavit of the secretary of the Company to prove up the consent. The court noted that the Consent, along with other evidence, revealed “a combination of [Lone Star] entities” engaged in the business of constructing pipelines for the transportation of natural gas liquids as referred to in Tex. Bus. Orgs. Code Ann. § 2.105. The secretary’s affidavit outlined the history and relationship of the Lone Star entities and attached various documents, including the LLC agreements of the Company and Lone Star GP LLC. The LLC agreements addressed the management of Lone Star GP LLC and the powers of the officers of the Company and Lone Star GP LLC. The evidence submitted by Lone Star with its motion for summary judgment established that, at the time Warren executed the Consent, he was the chairman and CEO of the Company (which was formerly known by another name), which was the sole member of Lone Star GP LLC (which was formerly known by another name), which was the general partner of Lone Star (which was formerly known by another name). The landowners argued, however, that Lone Star was required to prove that the governing agreements authorized Warren, as CEO of the Company, to declare a necessity to use eminent domain “singly.”

The court pointed out provisions of the LLC agreement of the Company and actions of the sole member of the Company supporting Warren’s authority and concluded that, even assuming the LLC agreement of the Company did not expressly confer authority on Warren to “singly” sign a Consent determining public necessity, other evidence established that Lone Star and the Company ratified Warren’s declaration of necessity in the Consent. The court thus concluded that Lone Star’s general partner, acting through its sole member, duly determined the public necessity and that the Consent form coupled with the Company’s ratification of the Consent sufficiently established public necessity.

The landowners further argued that the Company was not the sole member of Lone Star GP LLC, but the court concluded that the evidence clearly established that the Company was the sole member of Lone Star GP LLC despite a mistaken reference in the LLC agreement of Lone Star GP LLC.

Finally, the landowners complained that “an officer signed the Consent, not the member, and nothing grants any agent, manager or officer the power of eminent domain.” (Presumably, although it is not entirely clear from the opinion, this reference to “the member” is a reference to the Company itself, as the sole member of the general partner, as opposed to the Company’s member, which was yet another LLC.) While the power to determine necessity for purposes of eminent domain may be validly delegated, the landowners asserted that the officers of the Company lacked express authority to authorize condemnation. The court responded that the evidence made “clear that the member is governed by the officers, who are authorized to act on behalf of the company,” and that the secretary’s affidavit specifically declared that “the general partner of Lone Star NGL Pipeline LP has throughout the Lone Star pipeline project at issue delegated responsibility to officers of the general partner and their designees, including” the engineer whose study was the basis for determining the proposed route. The court further relied on the Delaware LLC statute (the entities were organized in Delaware and agreed that Delaware law would govern their agreements), which provides that, unless otherwise provided in the LLC agreement:

a member or manager of a limited liability company has the power and authority to delegate to 1 or more other persons any or all of the member’s or manager’s, as the case may be, rights, powers and duties to manage and control the business and affairs of the limited liability company. Any such delegation may be to agents, officers and employees of a member or manager or the limited liability company[.]

6 Del. C. § 18-407. The court said that it would interpret the Company's LLC agreement to grant all necessary powers to the officers to conduct the affairs of the company, unless specifically proscribed, citing 6 Del. C. § 18-1101(b) ("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 landowners argued that the secretary's affidavit should be ignored because it attempted to redefine the express terms of the LLC agreements of the Company and Lone Star GP LLC. In essence, the landowners argued that orders, resolutions, and minutes were the only acceptable evidence of official company proceedings. The court rejected this argument, stating that the eminent domain statutes do not limit the type of evidence that may be presented by a condemnor in this respect.

In sum, the court concluded that Lone Star conclusively established that authority had been properly delegated to Warren, the CEO of the Company, and that the Consent executed by Warren as the CEO of the sole member of Lone Star's general partner contained a valid declaration of necessity.

***Hardy v. Kroger Co.***, Civil Action No. 6:17-CV-00417-JDK, 2019 WL 1306217 (E.D. Tex. Jan. 24, 2019).

The court applied the corporate vice-principal doctrine in analyzing whether a limited partnership could be liable for punitive damages based on the alleged gross negligence of the limited partnership in connection with an accident involving a motorized shopping cart that occurred at a grocery store operated by the limited partnership.

The plaintiff sued Kroger Texas, L.P. ("Kroger"), a limited partnership, alleging premises liability, general negligence, and gross negligence in connection with an accident involving a motorized shopping cart that occurred at a grocery store operated by the limited partnership. Kroger argued that the plaintiff had "no evidence that Kroger as a corporate entity either directed or ratified an employee's allegedly grossly negligent acts/omissions" and that the plaintiff thus could not "impute punitive or exemplary damages upon Kroger as a corporate entity." Texas courts have adopted Section 909 of the Restatement of Torts, under which a principal is liable for exemplary or punitive damages for the acts of an agent only if: "(a) the principal authorized the doing and the manner of the act, or (b) the agent was unfit and the principal was reckless in employing him, or (c) the agent was employed in a managerial capacity and was acting in the scope of employment, or (d) the employer or a manager of the employer ratified or approved the act." According to the court, "Texas case law assessing whether a limited partnership principal may be liable for exemplary or punitive damages because of the acts of its agent employee is limited. Nonetheless, decisions of a limited partnership, much like a corporation, 'are ultimately made by human agents.'"

In the corporate context, the Texas Supreme Court has held that punitive damages are warranted only when the act is that of the corporation itself rather than the act of an ordinary servant or agent. The supreme court has identified four classes of individual agents who may constitute a "vice principal" whose acts may be deemed to be acts of the corporation for purposes of assessing exemplary damages. These four classes include (1) those who have authority to employ, direct, and discharge servants of the master, and (2) those to whom a master has confided the management of a department or division of the business. Because the plaintiff provided summary judgment evidence that would allow a reasonable jury to conclude that the store manager at the time of the incident was responsible for the management of a division of Kroger's business (the "entire store" where the incident occurred) and directed employees on behalf of Kroger, the court denied Kroger's motion for summary judgment.

***Pierce v. Fondren Orthopedic Group, LLP***, Civ. A. No. H-18-1686, 2018 WL 6200049 (S.D. Tex. Nov. 28, 2018).

The court denied (a) Peggy Pierce's and Fondren Orthopedic, Ltd.'s ("FOLTD") cross-motions for summary judgment on a breach-of-contract claim, and (b) Snow Goose Corporation's motion to intervene.

FOLTD was a Texas limited partnership formed for the purpose of investing in a hospital. The general partner of FOLTD was Snow Goose Corporation. In the breach-of-contract claim before the court, Pierce alleged that FOLTD had breached an agreement which allegedly obligated it to pay Pierce for five years after her termination from a FOLTD affiliate. The agreement was signed by Dr. G. William Woods, M.D. in his capacity as the President of Snow Goose.

The court concluded that the agreement was supported by consideration and did not excuse FOLTD's performance in the event of a for-cause termination. The court then engaged in a lengthy discussion of whether Woods had actual or apparent authority to act on behalf of Snow Goose. FOLTD argued in part that Woods lacked actual authority to enter into the agreement because Pierce was an officer of Snow Goose, and the Snow Goose



bylaws apparently required contracts between Snow Goose and Snow Goose officers to be approved by the Snow Goose board of directors. The court rejected the argument:

Plaintiff argues that her status as a Snow Goose officer is irrelevant to the enforceability of the Agreement because the Agreement was executed between Plaintiff and FOLTD, not Plaintiff and Snow Goose. The court agrees. The Agreement is between Plaintiff and FOLTD and has nothing to do with Plaintiff's involvement in the management of Snow Goose. The court is therefore not persuaded by Defendants' arguments that the Agreement required approval of the Snow Goose Board because of Plaintiff's alleged status as an officer of Snow Goose.

The court is also not persuaded by Defendants' argument that because Snow Goose is FOLTD's general partner, all FOLTD contracts are necessarily Snow Goose contracts. In its Cross-[Motion for Partial Summary Judgment], FOLTD cites *Peterson Group, Inc. v. PLTQ Lotus Group, L.P.*, 417 S.W.3d 46 (Tex. App.—Houston [1st Dist.] 2013, pet. denied), and *Pinebrook Properties, Ltd. v. Brookhaven Lake Property Owners Ass'n*, 77 S.W.3d 487 (Tex. App.—Texarkana 2002, pet. denied), in support of its argument that Texas law considers limited partnerships to be “one and the same” with their general partners.[footnote omitted] These cases merely held that the doctrine of alter ego does not apply to the general partners of limited partnerships because there is no need to “veil pierce” in order to hold general partners liable—general partners are already jointly and severally liable on partnership obligations. *Peterson Group*, 417 S.W.3d at 57; *Pinebrook Properties*, 77 S.W.3d at 499-500. The fact that Snow Goose could ultimately be held liable on one of FOLTD's obligations does not mean that Snow Goose was a party to all of FOLTD's contracts. The Agreement was between Plaintiff and FOLTD; it did not purport to create a Snow Goose obligation. The Agreement did not need to conform to the requirements of the Snow Goose Bylaws or Texas law regarding contracts between corporate officers and corporations.

Snow Goose's Bylaws are only relevant to determining whether Dr. Woods had actual authority to act on behalf of Snow Goose as its President.[footnote omitted] The president of a corporation has no inherent authority by virtue of his office. *See Franco-Texan Land Co. v. McCormick*, 23 S.W. 123, 124 (Tex. 1893); *Fitzhugh v. Franco-Texan Land Co.*, 16 S.W. 1078, 1079 (1891). In the absence of specific authority from the board of directors, the president of a corporation has no authority to contract for the corporation. *American Bank & Trust Co. v. Freeman*, 560 S.W.2d 444, 446 (Tex. Civ. App.—Beaumont 1977, writ ref'd n.r.e.). “[A]ctual authority of the president to contract on behalf of the corporation must be found either in specific statutes, in the organic law of the corporation, or in a delegation of authority from the board of directors formally expressed, or must be implied from the nature of his position or from custom or habit of doing business.” *Templeton v. Nocona Hills Owners Ass'n, Inc.*, 555 S.W.2d 534, 537 (Tex. Civ. App.—Texarkana 1977, no writ). The burden is on the party claiming authority to demonstrate that the president had actual authority to act on the corporation's behalf. *See In re Westec Corp.*, 434 F.2d 195, 200 (5th Cir. 1970).

Plaintiff presents no evidence that the Snow Goose Board of Directors expressly approved the Agreement signed by Dr. Woods. Because Dr. Woods has no inherent authority as President of Snow Goose under Texas Law and the Snow Goose Board did not approve the Agreement, the court must look to Snow Goose's Bylaws to determine whether Dr. Woods had express actual authority to act as a signatory for Snow Goose. Snow Goose's Bylaws provide that “[t]he President [of Snow Goose] shall have general and active management and control of the business and affairs of the Company . . . .”

Texas courts faced with identical language in corporate bylaws have reached different conclusions as to what authority it gives to the corporation's president. In *Fortenberry v. Cavanaugh*, No. 03-07-00310-CV, 2008 WL 4997568, at \*13-16 (Tex. App.—Austin Nov. 26, 2008, pet. denied), the court evaluated identical language and concluded that the bylaws as a whole did not authorize a corporate president to act on behalf of the company without specific board authorization, despite the language's seemingly broad grant of authority, because of other delegations to the board of directors in the bylaws. Another court concluded that the same language

authorized the president to act as a general manager, and that under Texas law the general manager has authority to act as an agent for the corporation and bind the corporation by contract. *Holman v. Dow*, 467 S.W.2d 547, 552 (Tex. Civ. App.—Beaumont 1971, writ ref'd n.r.e.).

The Snow Goose Bylaws have seemingly conflicting grants of authority to the President and Board of Directors, with broad and somewhat overlapping grants of power to each.[footnote omitted] The court concludes that the description of Dr. Woods' responsibilities in the Snow Goose Bylaws is not sufficient, standing alone, to support a grant of actual authority to enter into contracts of all types for FOLTD. In the absence of an express grant of actual authority, the court must look to the conduct of Snow Goose and Dr. Woods to determine if Dr. Woods had implied actual authority to sign FOLTD contracts on behalf of Snow Goose.

Dr. Woods acted as a signatory for Snow Goose on documents presented as exhibits by both Plaintiff and Defendants.[footnote omitted] In her affidavit Pierce states that “[o]n behalf of FOLTD, Dr. Woods unilaterally negotiated, entered into, and signed contracts without a vote of the partners or any prior specific partnership approval.”[footnote omitted] Dr. Woods also acted as a signatory for Snow Goose on a 2005 compensation agreement between Pierce and FOLTD,[footnote omitted] and there is no evidence that the Snow Goose Board contested the 2005 agreement during the nine-year period between 2005 and 2014, when the Agreement challenged in this action was executed.

Thus, despite considerable evidence that Woods acted with actual authority, either express or implied, the court could not conclude as a matter of law that Woods either had or lacked actual authority.

The court then discussed the argument that FOLTD should be bound by the agreement because Woods had apparent authority to execute such an agreement and likewise determined that it could not conclude as a matter of law that Woods acted with or without apparent authority:

Apparent authority arises “ ‘either from a principal knowingly permitting an agent to hold [himself] out as having authority or by a principal’s actions which lack such ordinary care as to clothe an agent with the indicia of authority, thus leading a reasonably prudent person to believe that the agent has the authority [he] purports to exercise.’ ” *Gaines*, 235 S.W.3d at 182. The essential elements required to establish apparent authority are: (1) a reasonable belief in the mind of the third party of the agent’s authority, (2) generated by some holding out or neglect of the principal, and (3) a justifiable reliance on the authority. *2616 South Loop L.L.C. v. Health Source Home Care, Inc.*, 201 S.W.3d 349, 356 (Tex. App.—Houston [14th Dist.] 2006, no pet.). To be bound on an apparent authority theory the principal must have had full knowledge of all material facts. *Gaines*, 235 S.W.3d at 182.

To prove Dr. Woods had apparent authority Plaintiff must establish that Snow Goose created a reasonable belief in her mind that Dr. Woods had authority to act for Snow Goose. While Pierce points to instances in which Dr. Woods acted as a signatory for Snow Goose in negotiations for FOLTD, she has presented no evidence that Snow Goose’s Board held Dr. Woods out as authorized to execute agreements on behalf of FOLTD. Pierce also argues that the actions of Dr. Woods’ successor, Dr. Elkousy, are consistent with Dr. Woods having apparent authority because Dr. Elkousy, upon being made aware of the Agreement, did not object to its validity.[footnote omitted] Defendants have presented evidence that James Bennett, one of the three members of Snow Goose’s then Board of Directors, had no knowledge of the Agreement between FOLTD and Pierce.[footnote omitted]

In its Cross-MPSJ, FOLTD argues that Dr. Woods lacked apparent authority as a matter of law because Plaintiff was an insider, and therefore could not have formed a reasonable belief of Dr. Woods’ apparent authority. FOLTD cites *In re Westec Corp.*, 434 F.2d at 195, in which the Fifth Circuit held that an officer of a corporation could not rely on apparent authority of another officer of the same corporation to create a binding agreement on the corporation’s behalf. *Id.* at 196-200. The court is not persuaded by FOLTD’s argument. The Agreement is distinguishable from the one at issue in *Westec* because the Agreement did not impose an obligation on Snow Goose.

The court concludes that Plaintiff has presented evidence sufficient to create a fact issue on apparent authority based on her knowledge of prior, similar contracts executed by Dr. Woods and Snow Goose's acquiescence to such contracts.[footnote omitted] As discussed above, while there is a substantial amount of evidence that Dr. Woods had some form of authority, be that authority actual (express or implied) or apparent, to act for Snow Goose to bind FOLTD, the court cannot conclude as a matter of law that Dr. Woods either had or lacked apparent authority to act as a signatory for Snow Goose to bind FOLTD to the Agreement.

*Petras v. Mole*, Civ. A. No. 3:11-CV-1402-N, 2012 WL 13103200 (N.D. Tex. May 17, 2012). (Although the court issued this opinion in 2012, it is included in this year's update because it did not appear in the Westlaw database until recently.) (“[U]nder Texas partnership law, a partnership is liable for injury to a third party as a result of a wrongful act or omission or other actionable conduct of a partner acting in the ordinary course of business of the partnership or with the authority of the partnership. TEX. BUS. ORG. CODE § 152.303.”).

*Dallas Gas Partners, L.P. v. Prospect Energy Corporation*, Civ. A. No. G-04-669, 2005 WL 8159867 (S.D. Tex. Dec. 15, 2005), report and recommendation adopted, 2006 WL 8439487 (S.D. Tex. Feb. 16, 2006). (Although the court issued this opinion in 2005, it is included in this year's update because it did not appear in the Westlaw database until recently.)

Plaintiff Dallas Gas Partners, L.P. (“DGP”) had a general partner (David Nelson) and five limited partners (Nelson, Tom Muse, Jeffrey Weiss, Franklin Brinegar, and James Langdon). A dispute arose over whether DGP was bound by an LLC Membership Interest Purchase Agreement (the “LLC Agreement”) that all of the limited partners had agreed to in writing. The court concluded that DGP was bound:

Nevertheless, the salient point in this dispute is quite direct: is DGP bound by the mutual release agreements in Section 9 of the LLC agreement? It is undisputed that all of [DGP's] limited partners signed consents agreeing to the LLC agreement and that they were attached to the document. Plaintiff argues that the signatories signed only in their individual capacities and not as limited partners of DGP. This is a puzzling claim since their only interest in the Gas Solutions contract was as partners of DGP. More importantly, the signature pages each clearly contain the heading: “CONSENT AND AGREEMENT OF *LIMITED PARTNERS* OF GAS SOLUTIONS PARTNERSHIP II. LP [DGP]”. Id. The pages specifically refer to DGP's partnership agreement and highlight that the signatures were given by DGP's limited partners:

In addition, each *limited partner* of the Partnership agrees to and ratifies the provisions set forth in Section 9 of the foregoing LLC Membership Interest Purchase Agreement dated as of September 23, 2004.

Plaintiff's Ex. 11 (emphasis added). Thus, the evidence clearly shows that DGP's partners signed these pages in their capacities as limited partners and not in their “individual” capacities. As such, each of Plaintiff's partners agreed to the Section 9 release agreements. As stated above, the claim that they were fraudulently induced into agreeing to Section 9 is meritless.

Plaintiff attempts to avoid the ramifications of Section 9 by claiming that the LLC agreement is not binding on it because its general partner, David Nelson, did not sign the agreement. Nelson certainly signed the consent agreement attached to the LLC agreement. Although the signature page does not specifically state “general partner,” Plaintiff presents no case law holding that such specificity is required. Equally important, it is extremely difficult to understand what purpose there could be in having all of DGP's limited partners submit signature pages consenting to the LLC agreement if the signatures were never intended to have any binding effect.

Even if Nelson did not sign as a general partner, Plaintiff's claim fails. DGP's argument relies on the fact that its partnership agreement states that limited partners shall not be “allowed to take part in the management or control of the Partnership.” Since none of the limited partners were given management powers, Plaintiff claims, their signatures to the LLC agreement cannot bind DGP. However, both parties overlook the fact that Paragraph 9.1(c) of the partnership agreement gave Nelson the power DGP claims he lacked. That provision states, in relevant part,

that “[a] Limited Partner *who is not also a General Partner* shall not be . . . allowed to take part in the management or control of the Partnership . . .” This clause clearly contemplates that one like Nelson, who was both a limited partner and the general partner, is excluded from the restrictions on which Plaintiff relies. If this were not true, the partnership’s language would be superfluous. At a minimum, this provision allowed Nelson to act on behalf of the partnership without specifically naming himself as “general partner.” The Court therefore finds that the signature pages to the LLC agreement were intended to bind DGP to the terms stated therein and that they do so.

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

*Marshall v. Ribosome L.P.*, No. 01-18-00108-CV, 2019 WL 2041062 (Tex. App.—Houston [1st Dist.] May 9, 2019, no pet. h.) (mem. op.).

The court of appeals held that a limited partnership could not be liable for aiding and abetting the alleged breach of fiduciary duty by a trustee of trusts that were limited partners where the partnership complied with the requirements of the partnership agreement by paying distributions to the trusts, as opposed to making the distributions to the beneficiaries of the trusts as had been the practice before the trustee revoked her authorization for the distributions to be paid to the beneficiaries.

The court also held that a limited partner did not have a right to an accounting where the partnership agreement required certain information to be furnished to the limited partner and gave a right of access to books and records but did not provide the right to an accounting. The court pointed out that Tex. Bus. Orgs. Code § 153.105 provides that a limited partner’s rights may be created only by the certificate of formation, partnership agreement, or provisions of the statute, and the court stated that the limited partner did not identify any source conferring the right to an accounting.

The court also rejected the limited partner’s claim that the partnership owed him a fiduciary duty to provide an accounting based on his limited partner status. The limited partner cited no authority for the proposition, and the court stated that it was clear that fiduciary powers or liabilities belonged to the general partner rather than the partnership, citing Tex. Bus. Orgs. Code § 153.152.

*Hammerhead Managing Partners, LLC v. Nostra Terra Oil & Gas Co., PLC*, Civil Action No. 3:18-CV-1160-N, 2019 WL 1403363 (N.D. Tex. Mar. 27, 2019).

The court dismissed the plaintiff’s breach-of-fiduciary-duty claim because the plaintiff’s complaint contained only conclusory allegations of the elements of a joint venture and did not identify any other special relationship giving rise to a fiduciary duty.

Hammerhead Managing Partners, LLC (“Hammerhead”) held a working interest in a tract of land known as the Pine Mills Oil Field. Hammerhead sued the other two working interest owners asserting various claims after they entered into a joint operating agreement without including Hammerhead. The court granted the defendants’ motion to dismiss several of Hammerhead’s claims, including the claim for breach of fiduciary duty. In that regard, the court explained:

Hammerhead alleges that Defendants Cue and GFP owed fiduciary duties to Hammerhead because they formed a joint venture under Texas law. The Court notes that merely pleading that the parties share an undivided interest in Pine Mill is not by itself sufficient because working interest owners in the same tract of land do not automatically owe each other fiduciary duties. *Zimmerman*, 409 S.W.2d at 614.

A joint venture exists when there is, among other things, an agreement to share profits and losses and a mutual right of control or management of the venture. *Pitts & Collard, L.L.P. v. Schechter*, 369 S.W.3d 301, 319 (Tex. App.—Houston [1st Dist.] 2011, no pet.). The Complaint does not contain factual allegations supporting the existence of a joint venture, and instead contains only a conclusory recital of the elements of a joint venture. Compl. at 21. And Hammerhead identifies no other special relationship, other than co-tenancy in the Pine Mills tract, that gives rise to a fiduciary relationship.

In a footnote, the court commented that the court found it interesting that Hammerhead sought to be part of and bound by the joint operating agreement when the joint operating agreement itself disclaimed any partnership.

*Synergy Strategic Solutions, LLC v. Totus Solutions, Inc.*, No. 3:16-CV-2649-S, 2019 1406599 (N.D. Tex. Mar. 3, 2019).

The court dismissed the plaintiff's claim for breach of fiduciary duty against the defendant with whom the plaintiff had entered into a contract and to whom the plaintiff had prepaid 50% of the purchase price of a product ordered from the defendant under the contract. The plaintiff did not allege any prior fiduciary relationship or any close and personal relationship of trust and confidence. Additionally, the contract disclaimed the creation of any joint venture or partnership. The plaintiff's allegations that the defendant held in constructive trust the monies prepaid to it by the plaintiff were insufficient to create a fiduciary relationship between the parties because a constructive trust does not give rise to a fiduciary relationship; to the contrary, a fiduciary relationship must exist prior to recognizing a constructive trust.

*Bombardier Aerospace Corporation v. SPEP Aircraft Holdings, LLC*, 572 S.W.3d 213 (Tex. 2019) ("A fiduciary duty arises 'as a matter of law in certain formal relationships, including attorney-client, partnership, and trustee relationships.'").

*Cruz v. Ghani*, No. 05-17-00566-CV, 2018 WL 6566642 (Tex. App.—Dallas Dec. 13, 2018, pet. filed) (mem. op.).

The court of appeals affirmed the trial court's judgment in part and reversed the judgment in part on various claims, including breach of fiduciary duty.

The lawsuit involved two medical imaging centers, North Dallas Medical Imaging, LP ("NDMI") and Plano AMI, LP. The general partner of NDMI was MCG Group, Inc. ("MCG"), and the general partner of Plano AMI was Ghani Medical Investments, Inc. ("GMI"). Appellant Dr. Erwin Cruz was involved in the formation of both businesses with appellee Mehrdad Ghani. After NDMI was dissolved and Cruz was expelled from Plano AMI, he filed a lawsuit in his own name and on behalf of the Erwin A. Cruz Family Limited Partnership, NDMI, Plano AMI, and GMI (collectively as appellants, "Cruz"). Following a multi-day trial, the jury resolved most questions in Cruz's favor and awarded actual and punitive damages. The trial court, however, granted Ghani's motion for JNOV and entered judgment for Ghani on all claims.

The jury found that Ghani failed to comply with his fiduciary duties to NDMI with respect to the dissolution of NDMI. (Ghani appeared to have some sort of management role in MCG.) On appeal, the court noted that the jury charge stated that MCG owed fiduciary duties as the general partner of NDMI, and "[t]o the extent Ghani exercised a degree of control over MCG such that he directed MCG's conduct as the general partner regarding the dissolution of NDMI, Ghani owed fiduciary duties to NDMI." The court of appeals concluded that there was some evidence to support the jury's answer that Ghani failed to comply with his fiduciary duties to NDMI:

Although Ghani provided an explanation about why NDMI needed to be dissolved and why the dissolution was not a breach of his fiduciary duties, evidence presented at trial allowed jurors to reach the opposite conclusion. Some evidence shows Ghani withheld financial information from Cruz immediately before seeking Cruz's consent to close the business. That information would have shown NDMI was not in financial straits and could continue operating as a profitable entity. Although Ghani stated the financial problems were due, in part, to declining reimbursement rates, Hakala [Cruz's damages expert] testified that occurred in 2006-2007 and the businesses had recovered financially. Further, although Ghani asserted referrals were declining because [referring physicians] were moving their practices away from Dallas, Hakala testified a change would have "some, but not that much" impact on future financial viability and Cruz stated the impact would be minimal.

A jury could reasonably infer that Ghani acted as he did because he no longer wanted to be in business with Cruz and wanted to pursue an opportunity with [his friend Reza] Nabavi. To accomplish this goal, Ghani falsely told Cruz there was "no money coming in, and we have big debt" to scare him into agreeing to close NDMI. Even as Ghani testified he was concerned about

reimbursement rates going down and the medical imaging industry becoming less profitable, he formed a new MRI entity with Nabavi to invest in and pursue opportunities in the same industry and in the same geographic area. Based on the contradictory evidence, the jury could have disregarded Ghani's explanation in favor of the one provided by Cruz.

This is some evidence Ghani placed his own interests before the interests of NDMI, used the advantage of his position to gain a benefit for himself at the expense of NDMI, or placed himself in a position where his self-interest might conflict with his obligations to NDMI. Thus, we conclude there is some evidence to support the jury's answer to Question 1 that Ghani failed to comply with his fiduciary duties to NDMI. . . . Because more than a scintilla of competent evidence supports the jury's answers . . . we conclude the trial court erred by disregarding the jury's answers and entering JNOV in Ghani's favor . . . .

The jury also found that Ghani failed to comply with his fiduciary duties to Plano AMI and GMI with respect to Ghani's pursuit of another medical imaging business ("Plano Open"). (Ghani was an officer/director of GMI.) On appeal, the court noted that the jury charge stated that GMI owed fiduciary duties to Plano AMI as its general partner, and that Ghani also owed fiduciary duties "to the extent Ghani exercised a degree of control over GMI such that he directed GMI's conduct as a general partner regarding the pursuit of Plano Open." The court also noted that Ghani's motion for JNOV did not challenge that he owed a fiduciary duty to Plano AMI and GMI.

Ghani argued that that the Plano AMI partnership agreement allowed him to pursue Plano Open and to compete with Plano AMI. In particular, paragraph 6.1(f) stated the following:

(f) Outside Activities and Conflicts of Interest. The General Partner or any Affiliate thereof and any director, officer, employee, agent, or representative of the General Partner or any Affiliate thereof shall be entitled to and may have business interests and engage in business activities in addition to those relating to the Partnership, including business interests and activities in direct competition with the Partnership. Neither the Partnership nor any of the Partners shall have any rights by virtue of this Agreement or the partnership relationship created hereby in any business ventures of the General Partner, any Affiliate thereof, or any director, officer, employee, agent, or representative of either the General Partner or any affiliate thereof.

After examining various provisions from Chapters 152 and 153 of the Texas Business Organizations Code, the court of appeals agreed that Ghani had not breached his fiduciary duty to Plano AMI:

Here, paragraph 6.1(f) of the Plano AMI Agreement expressly permitted GMI or any of its directors, officers, employees, agents, or representatives to "engage in business activities in addition to those relating to the Partnership, including business interests and activities in direct competition with the Partnership." Through paragraph 6.1(f), the Plano AMI Agreement identified a specific type of activity or category of activities that do not violate the duty of loyalty. *See* TEX. BUS. ORGS. CODE ANN. § 152.002(b)(2). Cruz does not argue the type of activity or category of activities identified in paragraph 6.1(f) are manifestly unreasonable. *See id.* We will honor the contractual terms the parties used to define the scope of their obligations and agreements, including limiting fiduciary duties that might otherwise exist.

Ghani, an officer or director of GMI, pursued Plano Open, which was a business interest in direct competition with Plano AMI. The parties, through the Plano AMI Agreement, expressly allowed Ghani to engage in a business in direct competition with Plano AMI. Because Ghani's actions about which Cruz complains were expressly permitted by the Plano AMI Agreement, we conclude the express limitation of fiduciary duties in the Plano AMI Agreement forecloses Cruz's Plano Open claim. Therefore, we conclude the trial court did not err by granting Ghani's motion for JNOV on [this question].

With respect to Ghani's fiduciary duty to GMI, however, the court found that there was some evidence of a breach:

Cruz, Ghani, and Taba [another doctor] discussed acquiring an open MRI machine to create an additional revenue stream for Plano AMI. Although the parties would have needed to lease additional space to add another machine, some evidence shows the open MRI could have been added to the existing business. Instead of pursuing the open MRI opportunity through GMI, Ghani and Taba created a new entity, GMI # 2. For Ghani and Taba, because the open MRI machine was not expensive and margins were high, the venture was profitable. This is some evidence Ghani placed his own interests before the interests of GMI or placed himself in a position where his self-interest might conflict with his obligations to GMI. Thus, we conclude there is some evidence to support the jury's answer to Question 5A that Ghani failed to comply with his fiduciary duties to GMI.

In a footnote, the court commented: "We do not conclude Ghani was required to use GMI as the general partner for the new open MRI entity as a matter of law. We only conclude that, in light of the jury charge as given, Ghani did not show he complied with his fiduciary obligations to GMI."

The parties also disputed the ownership structure of GMI and Plano AMI. Cruz maintained that he was a limited partner in Plano AMI and that he held stock in GMI. Ghani asserted that Cruz only owned stock in GMI. The court of appeals concluded that some evidence showed that Cruz was a limited partner in Plano AMI, owned stock in GMI, and that Ghani directed or participated in the conversion of both interests.

A separate jury question found that Ghani failed to comply with his fiduciary duties to NDMI by paying legal fees on behalf of his wife (Rona), who had been sued for work that she performed for NDMI. Cruz argued that Ghani breached his fiduciary duties by not causing NDMI to seek indemnification from Rona. The court of appeals disagreed, and upheld the JNOV for Ghani on this question:

When a party seeking indemnity, as Cruz argues NDMI should have, settles the claim of the potential indemnitor (Rona) without a judicial determination of the indemnitor's liability to the plaintiff (Ault), the party "must satisfy three elements in order to be entitled to indemnity: 1) that it was potentially liable to the plaintiffs; 2) that the settlement was made in good faith; and 3) that the settlement was a reasonable amount under the circumstances." *Id.* at \*5 (citing *St. Anthony's Hosp. v. Whitfield*, 946 S.W.2d 174, 179–80 (Tex. App.—Amarillo 1997, writ denied)). Upon such a showing, the indemnitee may recover the amount paid in settlement of the claim. *Id.* (citing *St. Anthony's Hosp.*, 946 S.W.2d at 179–80).

There was no judicial determination of Rona's liability to Ault. There is no evidence . . . in this record showing NDMI could have met the three elements listed above that are required to be entitled to indemnity. Even if we assume NDMI was potentially liable to Ault, there is no evidence the settlement was made in good faith or the amount of the settlement was reasonable.

Because we conclude there is no evidence NDMI was entitled to indemnification against Rona, we also conclude there is no evidence Ghani breached his fiduciary duty by not seeking that indemnification. Additionally, the jury's finding that Ghani breached his fiduciary duty by not seeking indemnification from Rona is against the great weight and preponderance of the evidence.

Another jury question found that Ghani breached his fiduciary duty to Plano AMI by paying a salary to himself. Ghani did not move for JNOV on the liability question and, therefore, did not challenge this finding. The trial court did not award damages to Cruz on this claim, however, and Cruz argued on appeal that the trial court should have ordered disgorgement of Ghani's compensation. The court began by discussing the law related to disgorgement:

Courts may fashion equitable remedies such as disgorgement and forfeiture to remedy a breach of a fiduciary duty. Disgorgement is an equitable forfeiture of benefits wrongfully obtained. A party may be required to forfeit benefits when a person rendering services to another in a relationship of trust breaches that trust. *See In re Longview Energy Co.*, 464 S.W.3d 361.

"We have said that such equitable forfeiture 'is not mainly compensatory . . . nor is it mainly punitive' and 'cannot . . . be measured by . . . actual damages.'" *Id.* (quoting *Burrow*, 997 S.W.2d at 240). Disgorgement is compensatory in the same sense attorney fees, interest, and costs

are, but it is not damages. As a result, equitable forfeiture is distinguishable from an award of actual damages incurred as a result of a breach of fiduciary duty. A claimant need not prove actual damages to succeed on a claim for forfeiture because they address different wrongs. In addition to serving as a deterrent, forfeiture can serve as restitution to a principal who did not receive the benefit of the bargain due to his agent's breach of fiduciary duty. However, forfeiture is not justified in every instance in which a fiduciary violates a legal duty because some violations are inadvertent or do not significantly harm the principal.

Whether a forfeiture should be imposed must be determined by the trial court based on the equity of the circumstances. However, certain matters may present fact issues for the jury to decide, such as whether or when the alleged misconduct occurred, the fiduciary's mental state and culpability, the value of the fiduciary's services, and the existence and amount of harm to the principal. Once the factual disputes have been resolved, the trial court must determine: (1) whether the fiduciary's conduct was a "clear and serious" breach of duty to the principal; (2) whether any monetary sum should be forfeited; and (3) if so, what the amount should be.

The court of appeals ultimately concluded that the request for disgorgement should be remanded to the trial court: "Although Cruz, in his sixth amended petition, sought 'disgorgement/fee forfeiture' for Ghani's misconduct and the issue was argued by counsel at the hearing on Ghani's motion for JNOV, the record does not show whether the trial court considered an equitable forfeiture award. Because Cruz requested the remedy and it was timely brought to the trial court's attention, we conclude the request for equitable relief should be remanded to the trial court for consideration of the factors described by the Texas Supreme Court in *ERI Consulting Engineers, Inc. v. Swinnea*, 318 S.W.3d 867, 875 (Tex. 2010)."

***Pierce v. Fondren Orthopedic Group, LLP***, Civ. A. No. H-18-1686, 2018 WL 6200049 (S.D. Tex. Nov. 28, 2018).

The court denied (a) Peggy Pierce's and Fondren Orthopedic, Ltd.'s ("FOLTD") cross-motions for summary judgment on a breach-of-contract claim, (b) Snow Goose Corporation's motion to intervene, and (c) FOLTD's motion for leave to file a third-party complaint.

FOLTD was a Texas limited partnership formed for the purpose of investing in a hospital. The general partner of FOLTD was Snow Goose Corporation. In the breach-of-contract claim before the court, Pierce alleged that FOLTD had breached an agreement which allegedly obligated it to pay Pierce for five years after her termination from a FOLTD affiliate. The agreement was signed by Dr. G. William Woods, M.D. in his capacity as the President of Snow Goose.

The court concluded that the agreement was supported by consideration and that the agreement did not excuse FOLTD's performance in the event of a for-cause termination. The court then engaged in a lengthy discussion of whether Woods had actual or apparent authority to act on behalf of Snow Goose. FOLTD argued in part that Woods lacked actual authority to enter into the agreement because Pierce was an officer of Snow Goose, and the Snow Goose bylaws apparently required contracts between Snow Goose and Snow Goose officers to be approved by the Snow Goose board of directors. The court rejected the argument:

Plaintiff argues that her status as a Snow Goose officer is irrelevant to the enforceability of the Agreement because the Agreement was executed between Plaintiff and FOLTD, not Plaintiff and Snow Goose. The court agrees. The Agreement is between Plaintiff and FOLTD and has nothing to do with Plaintiff's involvement in the management of Snow Goose. The court is therefore not persuaded by Defendants' arguments that the Agreement required approval of the Snow Goose Board because of Plaintiff's alleged status as an officer of Snow Goose.

The court is also not persuaded by Defendants' argument that because Snow Goose is FOLTD's general partner, all FOLTD contracts are necessarily Snow Goose contracts. In its Cross-[Motion for Partial Summary Judgment], FOLTD cites *Peterson Group, Inc. v. PLTQ Lotus Group, L.P.*, 417 S.W.3d 46 (Tex. App.—Houston [1st Dist.] 2013, pet. denied), and *Pinebrook Properties, Ltd. v. Brookhaven Lake Property Owners Ass'n*, 77 S.W.3d 487 (Tex. App.—Texarkana 2002, pet. denied), in support of its argument that Texas law considers limited partnerships to be "one and the same" with their general partners. These cases merely held that the



doctrine of alter ego does not apply to the general partners of limited partnerships because there is no need to “veil pierce” in order to hold general partners liable—general partners are already jointly and severally liable on partnership obligations. *Peterson Group*, 417 S.W.3d at 57; *Pinebrook Properties*, 77 S.W.3d at 499-500. The fact that Snow Goose could ultimately be held liable on one of FOLTD’s obligations does not mean that Snow Goose was a party to all of FOLTD’s contracts. The Agreement was between Plaintiff and FOLTD; it did not purport to create a Snow Goose obligation. The Agreement did not need to conform to the requirements of the Snow Goose Bylaws or Texas law regarding contracts between corporate officers and corporations.

The court ultimately determined, however, that fact questions on actual and apparent authority precluded the grant of summary judgment for any of the parties.

In rejecting Snow Goose’s motion to intervene, the court stated that “[m]erely because Snow Goose was FOLTD’s general partner and Snow Goose acted as FOLTD’s signatory does not make Snow Goose a party to the Agreement.” The court concluded that the interests of Snow Goose were adequately represented by FOLTD because the Agreement was between Pierce and FOLTD.

FOLTD also argued that it should be granted leave to file a third-party complaint against Woods pursuant to Federal Rule of Civil Procedure 14(a). FOLTD’s argument was that if FOLTD was found liable to Pierce, Woods would be liable to FOLTD because Woods breached his fiduciary duty to FOLTD in executing the agreement. The court observed that “[a] corporate general partner owes fiduciary duties to the limited partnership,” and it also stated that “an officer of a corporate general partner who is entrusted with the management of a limited partnership and who exercises control over the limited partnership owes a fiduciary duty to the limited partnership as well.” As a result, the court noted that “Snow Goose owes fiduciary duties to FOLTD,” and “[i]f Dr. Woods was vested with (and exercised) control over FOLTD by virtue of his position as President of Snow Goose, Dr. Woods owed fiduciary duties to FOLTD.” The court nevertheless denied FOLTD’s motion for leave:

FOLTD argues that in executing the Agreement, Dr. Woods breached his fiduciary duty to FOLTD. “The elements of a breach-of-fiduciary-duty claim [under Texas law] are: (1) a fiduciary relationship existed between the plaintiff and defendant; (2) the defendant breached its fiduciary duty to the plaintiff; and (3) the defendant’s breach resulted in injury to the plaintiff or benefit to the defendant.” *Neese v. Lyon*, 479 S.W.3d 368, 386 (Tex. App.—Dallas 2015, no pet.). Dr. Woods’ liability to FOLTD for breach of fiduciary duty is not contingent on the outcome of this case. Even if Dr. Woods had general authority to act for Snow Goose in executing contracts on behalf of FOLTD (which would make the Agreement valid) he could still be found liable to FOLTD if the Agreement was not in FOLTD’s best interests. If FOLTD is correct that Dr. Woods breached his fiduciary duties to FOLTD in entering into the Agreement with Plaintiff, FOLTD may have a claim against Dr. Woods regardless of how the court resolves Plaintiff’s claims. Any breach of fiduciary duty claim that FOLTD has against Dr. Woods may be pursued in a separate action between FOLTD and Dr. Woods. Because FOLTD’s proposed claim is not appropriate for Rule 14(a) impleader, FOLTD’s Motion for Leave to File a Third-Party Complaint will be denied.

***Cohen v. Flat Stone Development Company, Inc.***, Civil Action No. 4:16-CV-00283, 2018 WL 6411410 (S.D. Tex. Oct. 9, 2018).

The court granted summary judgment in favor of the general partner of several limited partnerships on claims for breach of fiduciary duty asserted against the general partner because the limited partnership agreements disclaimed any fiduciary duties owed by the general partner.

In this case involving disputes between the general and limited partners of three limited partnerships, the limited partnership agreements of each of the partnerships contained the following provision:

[T]he General Partner will not owe a fiduciary duty to the Partnership or any Partner. The General Partner will owe a duty of loyalty and a duty of care to the Partnership.

The court stated that “[t]he contract by its plain language distinguishes a fiduciary duty from duties of loyalty and care,” and “[f]ailing to give effect to this distinction would fail to ‘harmonize and give effect’ to both

sentences.” The court noted by way of footnote that each limited partnership agreement “[a]dditionally, . . . tracks the general meaning of the Texas statute governing the duties of general partners. *See* Tex. Bus. Orgs. Code Ann. § 152.204 (West Supp. 2018).” The court held that the parties intended to disclaim any fiduciary duties, and the court granted summary judgment as to the breach-of-fiduciary-duty claims against the general partner and dismissed those claims.

The court noted that its holding regarding the disclaimer of fiduciary duties did not automatically require dismissal of fraud-by-nondisclosure claims asserted by the limited partners and limited partnerships. The allegations did not state whether the duty of disclosure underlying the fraud-by-nondisclosure claims was based on the existence of a fiduciary relationship or a confidential relationship. Because a duty to disclose may arise from a confidential relationship, dismissal of those claims was not required.

***PNC Bank, N.A. v. 2013 Travis Oak Creek GP, LLC***, 1:17-CV-584-RP, 1:17-CV-560-RP, 2018 WL 6431005 (W.D. Tex. Sep. 28, 2018).

The court held that a removed general partner of a limited partnership had standing to bring its claims for breach of fiduciary duty as direct claims because the removed general partner alleged claims that diminished the value of its interest exclusively rather than the value of the investment generally, but the court dismissed the claims for breach of fiduciary duty against the limited partners because the removed general partner did not allege sufficient control on the part of the limited partners to support the existence of a fiduciary duty.

PNC Bank, N.A. (“PNC”), Columbia Housing SLP Corporation (“Columbia Housing”), and 2013 Oak Creek GP, LLC (“Oak Creek GP”) agreed to form a limited partnership to develop a low-income apartment complex in Austin. PNC and Columbia Housing were the original limited partners, and Oak Creek GP was the original general partner. After construction defects were discovered in the project and problems arose in obtaining permanent financing, the limited partners removed Oak Creek GP as general partner. PNC, Columbia Housing, and the partnership sued Oak Creek GP and related parties alleging various causes of action, and the defendants counterclaimed alleging various causes of action, including breach of fiduciary duty.

The plaintiffs argued that Oak Creek GP lacked standing to pursue its counterclaim for breach of fiduciary duty on the basis that the claim belonged to the partnership and Oak Creek GP lacked authority to bring derivative claims on behalf of the partnership.

The court began its analysis by observing that a partnership is an entity distinct from its partners, and partners in a limited partnership have standing to pursue two types of claims: direct claims and derivative claims. A derivative action is required when an injury is in reality suffered by the limited partnership, and partners lack standing to recover personally for harms suffered by the partnership. Although partners do not have standing to sue for injuries to the partnership that merely diminish the value of the partner’s interest, “a partner who is ‘personally aggrieved’ may bring claims for those injuries he suffered directly.”

With respect to derivative claims, the court stated that a general partner acting with authority in a limited partnership may sue derivatively only when a majority-in-interest of partners agree or if otherwise provided in the partnership agreement. Tex. Bus. Orgs. Code §§ 152.209, 153.152(a). Oak Creek GP had been removed as the general partner, and even if Oak Creek GP were still the general partner, the terms of the partnership agreement did not permit it to pursue claims on behalf of the partnership without Columbia Housing’s consent. The plaintiffs argued that Oak Creek GP’s claims were derivative claims, and thus Oak Creek GP lacked standing to assert the claims, because it sought to recover for breaches of duties owed to the partnership, not Oak Creek GP.

The court contrasted case law in which recovery was sought for a unique injury to a partner versus case law in which a partner suffered a proportionate economic injury or loss of investment that stemmed from an injury to the partnership itself, pointing out that a partner has standing to bring the former type of claim as a direct claim but not the latter. Oak Creek GP’s complaint specifically alleged that the plaintiffs owed both Oak Creek GP and the partnership fiduciary duties, and (unlike cases alleging mismanagement of partnership funds or diminished partnership interests) Oak Creek GP alleged unique losses suffered personally as follows: (1) the purported loss of Oak Creek GP’s rights to distributions of partnership cash flow, (2) the purported termination of a promissory note owed to Oak Creek GP; and (3) the an affiliated developer’s deferred development fees. With respect to the first injury, the court stated that Oak Creek GP could not sue directly for “distributions, profits, and other benefits” allegedly lost because of harms suffered by the partnership, but the remaining two injuries allegedly resulting from breach of fiduciary duty were unique to one or more counterclaimants. Thus, Oak Creek GP’s claim involved

matters that diminished the value of its interest exclusively, rather than the investment in the limited partnership generally, and the allegations were sufficient to establish standing to pursue its fiduciary-duty claim.

The court next considered whether Oak Creek GP's breach-of-fiduciary-duty claims should be dismissed for failure to state a claim. Oak Creek GP alleged that PNC and Columbia Housing "were never passive limited partners in the Partnership" and that by assuming control of actions reserved for the general partner, they owed a fiduciary duty to both the partnership and Oak Creek GP. To state a claim for breach of fiduciary duty, a plaintiff must show: (1) the existence of a fiduciary duty, (2) breach of the duty, (3) causation, and (4) damages. The plaintiffs argued that Oak Creek GP failed to state a claim for relief because it did not show that PNC or Columbia Housing owed Oak Creek GP any fiduciary duties.

The court explained that a limited partnership typically "consists of passive limited partners and a single, corporate general partner who manages the business of the partnership," and the court stated that limited partners, as such, generally do not owe duties to the partnership or the partners. After then characterizing the question of whether limited partners owe fiduciary duties to their partners under Texas law as "an open question," the court stated: "The statute governing limited partnerships, however, makes clear that '[a] limited partner shall not have any obligation or duty of a general partner solely by reason of being a limited partner.' Tex. Bus. Org. Code § 153.003(c). Instead something more is required: control. *See* Tex. Bus. Org. Code § 153.102(b)."

The court relied on *Strebel v. Wimberly*, 371 S.W.3d 267, 279 (Tex. App.—Houston [1st Dist.] 2012, pet. denied) for the proposition that "[s]tatus as a limited partner does not insulate one from 'fiduciary duties that arise when a limited partner also takes on a nonpassive role by exercising control over the partnership.'" The court further explained:

Texas law does not define what constitutes "control," but it does enumerate specific actions that are not considered participation in the control of a business. *See* Tex. Bus. Org. Code § 153.103. When courts find fiduciary duties are owed by a limited partner to a general partner, a common theme is that the partner has passed on from its role as a "passive investor" to a "nonpassive role" that justifies the recognition of fiduciary duties. *See, e.g., McBeth*, 565 F.3d at 178 & n.1 (declining to decide that fiduciary duties to a general partner arose solely based on status as a limited partner and instead concluding that the limited partner "was in a position of control"); *Strebel*, 371 S.W.3d at 279; *Crawford v. Ancira*, 1997 WL 214835, at \*5 (Tex. App.—San Antonio Apr. 30, 1997, no writ) (not designated for publication) (noting that because limited partners lack managerial powers of general partners, the law "contemplates that limited partners do not necessarily have a duty to act for or give advice for the benefit of the other partners or a duty to subordinate their own interests to the interests of the other partners"); *see also* Tex. Bus. Org. Code § 153.102(a). In such a case, fiduciary duties "exist by virtue of the additional relationship, such as agent or employee . . . or by contract." *Strebel*, 371 S.W.3d at 279.

The court provided examples from *Zinda v. McCann Street, Ltd.*, 178 S.W.3d 883, 890 (Tex. App.—Texarkana 2005, pet. denied) and *McBeth v. Carpenter*, 565 F.3d 171 (5th Cir. 2009) of situations in which a limited partner occupied a controlling role with respect to the partnership and was held to owe a fiduciary duty.

In the case at bar, Oak Creek GP argued that the partnership agreement conferred control on PNC and Columbia Housing, but the court found the provisions of the partnership agreement insufficient to impose fiduciary duties on a limited partner because "a limited partner does not participate in the control of the business because the limited partner . . . possesses or exercises one or more of the following powers: . . . (9) proposing, approving, or disapproving, by vote or otherwise, one or more of the following matters: . . . (D) the incurring, renewal, refinancing, or payment or other discharge of indebtedness by the limited partnership." Tex. Bus. Orgs. Code § 153.103. The partnership agreement here expressly provided that the general partner was "responsible for the management of the Partnership business" subject to restrictions that required Columbia Housing's consent, and the agreement prohibited the limited partners from interfering with the general partner's control. According to the court, "[t]he mere fact that an agreement requires a [sic] limited partners' consent is insufficient to impose fiduciary duties."

Oak Creek GP did not base its fiduciary-duty claim solely on the terms of the partnership agreement but further argued that PNC usurped Oak Creek GP's role as general partner and injected itself into the negotiation process regarding the partnership's financing. The court remained unconvinced that sufficient "control" was

exercised to find a fiduciary duty. The court again pointed out that approving or disapproving “the incurring, renewal, refinancing, or payment or other discharge of indebtedness by the limited partnership” is specified among the matters that are excluded as “control” over the partnership. Tex. Bus. Orgs. Code § 153.103(9)(D). Furthermore, the court said that cases finding a fiduciary duty owed by a limited partner involve the exercise of “dominant operating control” over the limited partnership’s affairs, and Oak Creek GP did not allege PNC exerted operational control—only that PNC was involved in loan modification negotiations. The court stated that “[o]perational control suggests power over the day-to-day affairs of an entity, not approval or influence over isolated, ancillary decisions.” The loan may have been instrumental to avoid consequences under the commitment for permanent financing, but that did not mean PNC assumed operational control since Oak Creek GP was free to, and did, seek alternative sources of financing. The court thus dismissed the counterclaims for breach of fiduciary duty.

*Chapman v. Arfeen*, No. 09-16-00272-CV, 2018 WL 4139001 (Tex. App.—Beaumont Aug. 30, 2018, pet. denied) (mem. op.).

Joe Chapman appealed a summary judgment order that rejected his request for a declaratory judgment about his ownership interests in limited partnerships and dismissed his claims against defendants for breach of fiduciary duty and other actions. Defendants also appealed a summary judgment order that dismissed their claims against Chapman for breach of fiduciary duty. The court of appeals affirmed in part and reversed in part.

Chapman owned limited partner interests in various Harbor Hospice limited partnerships. He alleged that after he resigned from his employment, he was told that he was no longer a limited partner and that his limited partner interests had been converted into profit interests. To support their position that Chapman’s ownership interests were voluntarily converted into “profit interests paid out as bonuses,” defendants relied upon documentary evidence in the form of assignments and redemption agreements, as well as Chapman’s ratification of such agreements by accepting, without objection, periodic “bonus profit payments.” The court of appeals found that the trial court erred in granting summary judgment against Chapman on this claim, as there were genuine issues of material fact and problems with an affidavit relied upon by the defendants.

The defendants also claimed that the statute of limitations barred Chapman’s claims because he was aware of the transfers or assignments of his ownership interests for more than four years before he sued. The court noted that Chapman’s request for declaratory judgment and his claims for breach of the partnership agreement and breach of fiduciary duty were governed by a four-year limitations period. The court observed that, even though Chapman indicated that he did not review his K-1s when he received them, he was deemed to have constructive notice of the changes they reflected to his ownership interests. This was because “[w]hen an individual signs a Form 1040 when filing their income tax with the IRS, they are signing ‘[u]nder penalties of perjury’ that the signor has ‘examined this return and accompanying schedules and statements, and to the best of [their] knowledge and belief, they are true, correct[.]’” Nevertheless, after a lengthy discussion, the court concluded that defendants failed to conclusively establish that the statute of limitations barred Chapman’s four-year claims (although limitations did bar Chapman’s two-year claims for conversion and theft). The court also concluded that genuine issues of material fact existed on the assertion that Chapman had ratified the transfer of his ownership interests into profit interests.

Chapman also argued that he was verbally promised a 2% limited partner interest in 39 related entities. The 39 entities raised a statute-of-frauds defense, claiming that an oral agreement which is not to be performed within one year from the date of making the agreement is unenforceable. The court referenced the 99-year term of the partnerships (which was stated in the partnership agreements) and concluded that the statute-of-frauds defense was valid:

Based on the language in the agreements, the agreements did not contemplate that the undertaking would be completed within a year. Additionally, even Chapman’s account that they would be partners and work together for years does not indicate that the alleged promise could be completed within a year. Finally, a large number of the Thirty-Nine Entities did not come into existence until after 2006. We conclude the agreement concerned an undertaking that could not be completed within a year. Because the statute of frauds applies to the alleged promise regarding the Thirty-Nine Entities, the oral promise, unaccompanied with a written document, is unenforceable.

The court also reaffirmed that the statute of frauds applies to partnerships:

Chapman also argues that the statute of frauds does not apply to the partnerships in his case. We disagree. Relying on *Citrin Holdings, LLC v. Minnis*, No. 14-11-00644-CV, 2013 WL 1928652 (Tex. App.—Houston [14th Dist.] May 9, 2013, pet. denied), Chapman contends that the statute of frauds does not apply to his claims because he raised a fact issue as to whether he established a statutory partnership as provided by section 152.052(a) of the Texas Business Organizations Code. However, *Citrin Holdings* does not hold that section 152.052 provides an exception to the application of the statute of frauds for partnerships; but rather, that the statute of frauds does not prevent a plaintiff from seeking recovery of his out-of-pocket damages because he relied upon an oral promise. Chapman did not complain in the trial court or on appeal that the alleged oral promise to be partners with Arfeen in all future Harbor entities resulted in him suffering out-of-pocket damages. We overrule Chapman’s claims that the statute of frauds does not apply to the Thirty-Nine Entities to which he claims he has an ownership interest.

Chapman argued that promissory estoppel was an exception to the statute of frauds, and the court agreed. He asserted that his reliance on the alleged oral agreement was evidenced by the fact that he continued to work for the partnerships and assisted them in return for his promised ownership interests. The court rejected the argument, however, as it observed that Chapman was compensated for his work. As a result, he “[could not] rely on the fact [that] he continued to work to raise a fact issue on his promissory estoppel claim.”

With respect to Chapman’s motion for summary judgment, the defendants argued that the trial court improperly granted summary judgment against them on their breach-of-fiduciary-duty claim. Defendants alleged that Chapman had breached his fiduciary duty by (1) failing to notify them about a lawsuit by an entity claiming breach of contract; (2) failing to notify them about problems with a Harbor Hospice entity, which caused that entity to lose its operating license; and (3) failing to take any actions regarding Medicare issues which caused some of the defendants to incur fines for violating various federal regulations. Defendants asserted that all of these actions were “beyond the protections afforded by the business judgment rule.” The court disagreed:

Company officers owe a fiduciary duty to the company, which “‘includes the dedication of [their] uncorrupted business judgment for the sole benefit of the [company].’” *Ritchie v. Rupe*, 443 S.W.3d 856, 868 (Tex. 2014) (quoting *Int’l Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 577 (Tex. 1963)). As a fiduciary, a company officer owes the company “a strict duty of ‘good faith and candor,’ as well as ‘the general duty of full disclosure respecting matters affecting the principal’s interests’; there is a ‘general prohibition against the fiduciary’s using the relationship to benefit his personal interest, except with the full knowledge and consent of the principal.’” *Hawthorne v. Guenther*, 917 S.W.2d 924, 934 (Tex. App.—Beaumont 1996, writ denied) (quoting *Chien v. Chen*, 759 S.W.2d 484, 495 (Tex. App.—Austin 1988, no writ)). Similarly, “[a] managing partner has a duty to administer the partnership affairs solely for the benefit of the partnership” and “may not place himself in a position where it benefits him to violate this duty.” *Id.*

However, the business judgment rule generally protects company officers and directors, who owe fiduciary duties to the company, from liability for alleged breaches of duties that are based on actions that are negligent, unwise, or imprudent if the actions were “‘within the exercise of their discretion and judgment in the development or prosecution of the enterprise in which their interests are involved.’” *Sneed v. Webre*, 465 S.W.3d 169, 178 (Tex. 2015) (quoting *Cates v. Sparkman*, 11 S.W.846, 849 (Tex. 1889)). Nonetheless, the business judgment rule does not apply to protect a company officer from liability for acts that are dishonest, fraudulent, or self-dealing. *Id.*

Defendants claim Chapman’s actions or inactions amount to gross-negligence, but they do not claim or argue that Chapman’s actions or inactions were fraudulent, dishonest, or that he engaged in any self-dealing. *See id.* Negligent or grossly negligent conduct falls within the business judgment rule. And, the summary judgment evidence is undisputed that Arfeen knew that the entity sued one of Arfeen’s entities, as Arfeen hired an attorney to defend the suit. Based on our review of the record, we conclude Chapman established the business judgment rule applied to the conduct the Defendants relied on for their breach of fiduciary duty and breach of loyalty claims.

*Tin Star Development, LLC v. 360 Residential, LLC*, No. 05-17-00040-CV, 2018 WL 1804891 (Tex. App.—Dallas Apr. 17, 2018, no pet.) (mem. op.).

The court affirmed a summary judgment against the plaintiff on its breach-of-fiduciary-duty claim because the plaintiff failed to raise a fact issue as to the existence of either a joint venture or an informal fiduciary relationship.

The plaintiff, Tin Star Development, LLC (“Tin Star”), sued 360 Residential, LLC (“360 Residential”), alleging various causes of action arising out of a dispute involving a real estate development. One of Tin Star’s claims was for breach of fiduciary duty, and the trial court granted 360 Residential’s motion for summary judgment against Tin Star on this claim.

Although 360 Residential challenged all three elements of Tin Star’s claim for breach of fiduciary duty—(1) a fiduciary relationship between the plaintiff and defendant, (2) breach of the fiduciary duty by the defendant, and (3) injury to the plaintiff or benefit to the defendant as result of the breach—the court of appeals only found it necessary to discuss the first element because Tin Star failed to raise a fact issue on the existence of a fiduciary relationship. Tin Star argued that there was evidence of a joint venture or an informal fiduciary relationship. The court stated that joint venturers owe each other fiduciary duties, and the court listed the elements of a joint venture as: (1) an express or implied agreement to engage in a joint venture, (2) a community of interest in the venture, (3) an agreement to share profits and losses from the enterprise, and (4) a mutual right of control or management of the enterprise. Although there was testimony that the parties contemplated a future joint venture, there was no testimony that a joint venture existed between Tin Star and 360 Residential. They did not agree, for example, to share profits and losses from an enterprise. Instead, Tin Star and 360 Residential each formed an LLC subsidiary, and those two LLCs entered into an LLC agreement with each other forming another LLC. Thus, there was no joint venture relationship between Tin Star and 360 Residential giving rise to a fiduciary relationship. Although Tin Star also alleged the existence of an informal fiduciary relationship based on its reliance on 360 Residential’s investment expertise, subjective trust between parties in an arms-length transaction does not transform a business relationship into a fiduciary relationship, and Tin Star failed to raise a fact issue as to the existence of an informal fiduciary relationship.

#### **F. Partnership Property and Partnership Interest**

*United States for Use and Benefit of PBT and JBJ Alliance v. Frankenmuth Mutual Insurance Company*, Civil Action No. 3:18-CV-2785-B, 2019 WL 1979362 (N.D. Tex. May 3, 2019).

In a suit to recover under a subcontract brought by the party that was named in the contract, the court dismissed as a plaintiff a party who was not named in the contract but claimed to be one of two joint venturers comprising the named party. The court stated that the plaintiff who was not a named party did not have the right to pursue the action in its own name without joining the other partner. The plaintiffs could either amend and add the other partner as a plaintiff or sue only in the name of the partnership.

PBT and JBJ Alliance (the “Alliance”) and JBJ Restoration, LLC (“JBJ LLC”) sued on a subcontract entered into in the name of the Alliance. The defendant argued that JBJ LLC lacked any contractual relationship with it and did not have standing to sue. The plaintiffs claimed that the Alliance was an unincorporated association of two companies—a joint venture between JBJ LLC and Purple Building Technologies, Inc. (“PBT Inc.”). Plaintiffs argued that JBJ LLC, as a member of the joint venture, was one of the two real parties in interest and that its claims were one and the same as those of the Alliance’s such that joinder of JBJ LLC was proper. The court stated that the ability of parties who are not individuals or corporations to sue in federal court is determined by state law, and the court explained Texas law as follows:

Generally, under Texas law, a joint venture is governed by the rules applicable to partnerships. *Smith v. Deneve*, 285 S.W.3d 904, 913 (Tex. App.—Dallas 2009, no pet.). Under Texas partnership law, a partnership is “an entity distinct from its partners.” *Am. Star Energy & Minerals Corp. v. Stowers*, 457 S.W.3d 427, 429 (Tex. 2015). “As an independent entity, a partnership may enter into contracts in its own name, may own its own property, and may sue and be sued in its own name.” *Id.* The general rule is that “a partnership cause of action belongs to and is the specific property of the partnership” and a partner may not “bring suit either on such a cause of action as a whole, whether in the name of the partnership or in [its] own name, or for the fractional share of such a

cause of action corresponding to [its] fractional interest in the partnership.” *Cates v. Int’l Tel. & Tel. Corp.*, 756 F.2d 1161, 1176 (5th Cir. 1985). However, an exception to this general rule allows partners to bring a suit individually based on a contract made on behalf of the partnership if all partners are made parties to the suit. *See id.*; *see also Chien v. Chen*, 759 S.W.2d 484, 490–91 (Tex. App.—Austin 1988, no pet.).

Thus, although the contract was entered into in the name of the Alliance, JBJ LLC and PBT Inc. had the capacity under Texas law to bring suit on behalf of the partnership if they were both joined. Because only one of the two partners was currently joined to the suit, its joinder was improper. The court thus granted the defendant’s motion to dismiss JBJ LLC’s claims without prejudice and granted leave to the plaintiffs to amend their complaint to join PBT Inc. as a party or to sue only in the name of the partnership.

*Etheridge v. Opitz*, No. 12-18-00088-CV, 2019 WL 1416853 (Tex. App.—Tyler Mar. 29, 2019, no pet. h.) (mem. op.).

In a post-divorce action for division of several tracts of property that the ex-wife claimed were purchased by the couple during marriage and were not divided in the divorce decree, the court of appeals held that certain tracts were owned by the couple and other tracts were owned by a partnership formed during the marriage (the couple’s community interest in the partnership was awarded to the ex-husband in the divorce). Thus, the ex-wife was entitled to partition of the tracts that were owned as community property, but the ex-wife had no interest in the property that was partnership property.

Jaime Etheridge brought a post-divorce action for division of six tracts of land purchased during her marriage to Eric Opitz. Jaime asserted that these tracts of land were community property that had not been divided in the divorce decree. The divorce decree awarded the couple’s residence and the community interest in a dairy business known as Summit Dairy to Eric and imposed the debt associated with both the residence and Summit Dairy on Eric. Jaime was awarded \$50,000 for “her community interest in the marital residence and in the business known as Summit Dairy.” The tracts of land at issue, title to which was held in the names of Eric and Jaime (and in the case of three of the tracts, in the names of Eric, Jaime, and Eric’s parents), were not specifically mentioned in the divorce decree.

Eric’s theory at trial, which was not pleaded by Eric, was that the property at issue was partnership property belonging to Summit Dairy, and Jaime complained that this assertion required a verified plea. The court of appeals held that Eric’s assertion that the property was owned by the partnership under partnership law was not an argument of lack of capacity or a defect in parties and thus did not require a verified plea under Tex. R. Civ. Pro. 93.

At trial, the jury found that Jaime had no interest in any of the tracts, and the trial court entered judgment that Jaime take nothing on her claims of ownership in the six tracts of land. Jaime argued on appeal that the trial court erred in submitting an instruction that included the text of Tex. Bus. Orgs. Code § 152.102 regarding the classification of partnership property. The charge also included an instruction based on the presumption under the Texas Family Code that property acquired during marriage is community property. The court of appeals concluded that the trial court did not err in submitting the instruction on partnership property.

With regard to the sufficiency of the evidence, the court of appeals concluded that there was no evidence to rebut the community presumption as to three of the six tracts of land at issue. The first three tracts were acquired in 2002 in the names of Eric, Jaime, and Eric’s parents. At this time, Eric and Jaime were married, but the partnership was not yet in existence. Eric attempted to rebut the community presumption with evidence that the properties were purchased with partnership funds, but the court pointed out that the partnership was not yet in existence at the time of the deeds and stated that “[t]he community character of the property is determined by the date of the deed, not by the date the purchase price is paid.” In the absence of evidence rebutting the community presumption, the court examined the record for any evidence of a conveyance of these tracts to the partnership. “To convey to the partnership title to property owned by one partner at the formation of the partnership, or to make such property a partnership asset, there must be a written agreement, the same as any other contract for the sale of land.” There was no evidence of such a conveyance. All vital facts in support of Jaime’s community property interest were established as a matter of law, and the trial court erred in divesting Jaime of her community interest in these tracts.

The court of appeals examined the evidence relating to the remaining three tracts of land and found there was sufficient evidence to support the implied finding that these three tracts were partnership property. These tracts were acquired in the names of Eric and Jaime after Eric and his father formed Summit Dairy as a partnership.

Although these properties were presumptively community based on their acquisition during marriage, “Eric’s testimony that an existing partnership paid for these properties, from the purchase date, is sufficient to rebut that presumption.” The court stated that this testimony “also launched the presumption that the property is partnership property” pursuant to Tex. Bus. Orgs. Code § 152.102. The court stated that the burden then fell on Jaime to rebut that presumption, and she did not do so. “Unlike the scenario involving the first three properties, when land is acquired for purposes of a existing partnership but is held in a partner’s name, the partnership’s claim to the land is not barred by the absence of a written document of conveyance. . . . Whether property used in the partnership operation is owned by the partnership is a matter of intention.” Both Jaime and Eric testified as to the payment of the down payment and monthly payments out of partnership funds, and Eric testified that neither he nor Jaime ever wrote a personal check to pay for “anything on that property.” The court stated that this evidence showed that the parties intended the property to be partnership property, and it was of no consequence that legal title was in the names of Jaime and Eric or that Jaime was not a partner. Thus, the evidence supported the jury’s finding that Jaime had no interest in these three tracts, and the appellate court affirmed the trial court’s judgment as to the ownership of these tracts.

*R. Hassell Builders, Inc. v. Texas Floor Service, Ltd.*, 546 S.W.3d 816 (Tex. App.—Houston [1st Dist.] 2018, pet. denied).

The defendant corporation in this case was not entitled to protection by the automatic stay entered in the bankruptcy of a partnership debtor—even though the corporation was related to the partnership—because the partnership was a separate legal entity from the corporation. Even assuming the defendant was a partner of the partnership debtor, which was not supported by the evidence, a partnership is an entity distinct from its partners, and the fact that a partner’s property may be used to satisfy a judgment against the partnership in some circumstances does not transform the partner’s property into partnership property. Thus, the court rejected the argument that the stay should apply because the plaintiff sought to recover property of the bankruptcy estate held by the defendant.

See also the following cases summarized below under the heading “Standing or Capacity to Sue”: *Moss v. Princip*, 913 F.3d 508 (5th Cir. 2019); *PNC Bank, N.A. v. 2013 Travis Oak Creek GP, LLC*, 1:17-CV-584-RP, 1:17-CV-560-RP, 2018 WL 6431005 (W.D. Tex. Sep. 28, 2018); *County of El Paso v. Navar*, No. 08-17-00058-CV, 2018 WL 2715298 (Tex. App.—El Paso June 6, 2018, no pet.); *Roan Brothers Tile Company v. City of Garland*, Civ. A. No. 3:04-CV-1090-B ECF, 2006 WL 8437017 (N.D. Tex. Jan. 12, 2006),

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

### **1. Financial Rights and Obligations**

*Marshall v. Ribosome L.P.*, No. 01-18-00108-CV, 2019 WL 2041062 (Tex. App.—Houston [1st Dist.] May 9, 2019, no pet. h.) (mem. op.).

The court of appeals held that a limited partnership could not be liable for aiding and abetting the alleged breach of fiduciary duty by a trustee of trusts that were limited partners where the partnership complied with the requirements of the partnership agreement by paying distributions to the trusts, as opposed to making the distributions to the beneficiaries of the trusts as had been the practice before the trustee revoked her authorization for the distributions to be paid to the beneficiaries.

The court also held that a limited partner did not have a right to an accounting where the partnership agreement required certain information to be furnished to the limited partner and gave a right of access to books and records but did not provide the right to an accounting. The court pointed out that Tex. Bus. Orgs. Code § 153.105 provides that a limited partner’s rights may be created only by the certificate of formation, partnership agreement, or provisions of the statute, and the court stated that the limited partner did not identify any source conferring the right to an accounting.

The court also rejected the limited partner’s claim that the partnership owed him a fiduciary duty to provide an accounting based on his limited partner status. The limited partner cited no authority for the proposition, and



the court stated that it was clear that fiduciary powers or liabilities belonged to the general partner rather than the partnership, citing Tex. Bus. Orgs. Code § 153.152.

The court noted in a footnote that the limited partnership claimed that it was governed by British Virgin Islands law because it was formed under those laws, but the court assumed that application of Texas law would result in the same outcome because the parties did not argue otherwise, and a choice-of-law analysis was thus not necessary.

*ASR 2620-2630 Fountainview, LP v. ASR 2620-2630 Fountainview GP, LLC*, 2019 WL 470240, \_\_\_ S.W.3d \_\_\_ (Tex. App.—Houston [14th Dist.] 2019, no pet.).

The court of appeals held that a limited partner was a creditor of the partnership when that partner became entitled to a distribution under Delaware law. The court also determined that the trial court abused its discretion by reducing the partnership’s recovery to punish a non-party for contempt of court because there was an absence of mutuality and the offset was not permitted by the Texas Government Code.

In 2010, three entities executed a limited partnership agreement in which they formed ASR 2620-2630 Fountainview, LP, a Delaware limited partnership (the “Limited Partnership”). Under the partnership agreement, ASR 2620-2630 Fountainview GP, LLC (the “First General Partner”) was the general partner. Fountainview Park Plaza, LLC and ASRP Investments, LLC (collectively, the “Class A Partners”) were the two class A limited partners. American Spectrum Realty Operating Partnership, LP (the “Class B Partner”) was the sole class B limited partner. In April 2013, after they became dissatisfied with the First General Partner’s performance of its duties as general partner, the Class A Partners removed the First General Partner and selected Fountainview New GP, LLC (the “Second General Partner”) to be the general partner.

The Limited Partnership and the Class A Partners (collectively, “Park Plaza”) filed this suit, asserting claims for breach of the partnership agreement and breach of fiduciary duty against several entities involved with the Limited Partnership, including the First General Partner and the Class B Partner (collectively, “American Spectrum”).

After a dispute arose over entitlement to proceeds from the sale of Limited Partnership assets that were placed in a segregated bank account in accordance with an agreed temporary injunction, the Class B Partner filed counterclaims against Park Plaza alleging that the Limited Partnership breached the partnership agreement by failing to disburse the proceeds. American Spectrum filed a motion asking the trial court to hold Pamela Castleman, a representative of the Second General Partner, in contempt for violating the temporary injunction after she paid a real estate commission in the amount of \$266,400 from the segregated account to Victory Realty Solutions, Inc. (“Victory Realty Solutions”), a corporation that Castleman owned. Following a pre-trial contempt hearing, the trial court found that she caused the payment in violation of the temporary injunction and granted the motion (the “Contempt Order”). The Contempt Order announced “that the appropriate remedy . . . is an adjustment to the jury’s verdict in the amount of [\$266,400].” The Second General Partner, Castleman, and Victory Realty Solutions, Inc. were not parties to this litigation.

In the jury trial that followed, and relevant to this appeal, the jury found that the Limited Partnership failed to comply with the partnership agreement by not paying distributions under section 6.2. The jury found in favor of Park Plaza as to liability and damages on the breach-of-fiduciary claims against the First General Partner, awarding \$371,147 in damages to Park Plaza. The trial court rendered a final judgment in which it ordered that Park Plaza recover \$104,747—the damages found by the jury “less an offset of \$266,400 as set forth in the [Contempt Order].”

The first issue the court of appeals addressed was whether the general partner or Limited Partnership had the contractual obligation to make distributions under section 6.2 of the partnership agreement. The court began its analysis by noting that the First General Partner, the Class A Partners, and the Class B Partner (collectively, the “Partners”) formed the Limited Partnership under the Delaware Revised Limited Partnership Act (the “Act”); thus, Delaware law controlled the interpretation of the partnership agreement. The court cited a number of Delaware law propositions, including: (1) “[t]he Act’s stated policy is ‘to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements’”; (2) the traditional rules of contract interpretation apply; and (3) the Act permits a partnership agreement to limit or eliminate liability for breach of contract and breach of duties, except for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.

The provision at the center of the Class B Partner's claim for breach of the partnership agreement read as follows:

Section 6.2 Distribution of Partnership Capital Event Receipts. No later than fifteen (15) days after the closing of any Capital Transaction, all Partnership Capital Event Receipts (subject to requirements of applicable law with respect to the priority of other creditors of the Partnership, if any) shall be paid or distributed [according to a formula to determine the amount of the distribution to the Class A Partners and possibly to the Class B Partner].

The court observed that the Partners drafted section 6.2 in the passive voice and did not identify which entity or entities must pay or distribute the Partnership Capital Events Receipts. Park Plaza relied on other provisions of the partnership agreement to support its position that only the general partner had the duty and, therefore, only the general partner could be liable for the failure to make a distribution. The court, however, focused on Section 17-606(a) of the Act, which recognizes the status of a partner with the right to a distribution as follows:

Subject to §§ 17-607 and 17-804 of this title, *and unless otherwise provided in the partnership agreement*, at the time a partner becomes entitled to receive a distribution, he or she has the status of, and is entitled to all remedies available to, a creditor of the limited partnership with respect to the distribution. [emphasis added]

The court of appeals rejected Park Plaza's argument based on the partnership agreement and the Act. First, the court pointed out that Park Plaza did not dispute that the sale of the buildings triggered a distribution under section 6.2 or that the Class B Partner was entitled to receive such a distribution. Second, no party pleaded or proved the applicability of the limitations in either Section 17-607 (limiting distributions not in the dissolution and winding up context) or Section 17-804 (limiting distributions in the dissolution and winding up context). Further, the partnership agreement did *not* provide that when a partner became entitled to a distribution, the partner did not have the status of a creditor of the Limited Partnership *or* that such a partner was not entitled to the remedies available to a creditor. Because the partnership agreement did not provide otherwise, the court held that Section 17-606 applied to the distribution under section 6.2. Therefore, even if the partnership agreement did not impose on the Limited Partnership a duty to make a distribution under section 6.2, when the Class B Partner became entitled to receive a distribution, then the Class B Partner became a creditor of the Limited Partnership with respect to that distribution. Furthermore, the Class B Partner was entitled to assert a claim against the Limited Partnership for breach of the partnership agreement by failing to pay the distribution owed under section 6.2.

The second issue the court of appeals addressed was whether the trial court erred when it reduced Park Plaza's recovery against the First General Partner by \$266,400 to punish a non-party for their contempt of court. The trial court held Castleman in contempt of court for violating the temporary injunction after she caused an improper payment from a segregated account while acting as representative of the Second General Partner. After the jury awarded \$371,147 to Park Plaza in damages caused by the First General Partner's breach of fiduciary duty, the trial court's final judgment punished Castleman's contempt by offsetting \$266,400 against Park Plaza's recovery from the First General Partner.

The court of appeals prefaced its discussion with several presumptions: Castleman violated the temporary injunction by paying the improper commission; the trial court properly held her in criminal contempt; and the standard of review applicable to the trial court's offset order was for abuse of discretion.

Park Plaza (comprised of the Limited Partnership and the two Class A Partners) argued that the trial court misdirected punishment for Castleman's contempt. According to American Spectrum (comprised of the First General Partner, the Class B Partner, and other entities), Castleman controlled the Class A Partners, acted as their agent, and owned the company that received the commission. Thus, American Spectrum contended that it would not be equitable to allow the Class A Partners to avoid the consequences for Castleman's conduct. American Spectrum argued that the trial court had the discretion to order the offset as a penalty for Castleman's contempt and it was not abuse to determine that the appropriate equitable remedy was an offset against Park Plaza's recovery.

The court of appeals disagreed with American Spectrum for two reasons. First, the court concluded that there was an absence of mutual obligations between Park Plaza and the First General Partner in this case. The court cited the Texas Supreme Court in *Western Shoe Co. v. Amarillo Nat'l Bank* for the principle that there must be

mutuality in order to offset one obligation against another. 127 Tex. 369, 94 S.W.2d 125, 128 (1936) (“[I]n other words, the obligor of the first obligation must be the obligee of the second obligation and the obligee of [the] first obligation must be the obligor of the second obligation.”). Implicit in the court’s application of the *Western Shoe* framework is the view that the improper payment from the segregated account was the first obligation and Park Plaza’s recovery against the First General Partner was the second. Because the segregated account did not contain funds owned by the First General Partner, it could not be the obligee of the first obligation. As for the second obligation, the court of appeals reasoned that the only obligees were the three parties comprising Park Plaza (the Limited Partnership and the two Class A Partners, Fountainview Park Plaza and ASRP Investments), none of whom was Castleman or Victory Realty Solutions. The court determined that American Spectrum’s unsupported allegations of control and agency did not change that determination. No party had proved or obtained a jury finding as to alter ego or any other basis to pierce any entity’s veil. Thus, even if Castleman controlled the Class A Partners (both were LLCs), the court was required to treat each as having a separate legal existence. Similarly, there was no witness testimony or trial court finding that Castleman acted on behalf of either of the Class A Partners when she made the improper payment. As a result, even if Castleman previously acted as their agent, there was nothing to suggest that she was acting on behalf of either of the Class A Partners when she engaged in her contemptuous conduct. Therefore, the court of appeals held that the trial court’s offset order was an abuse of discretion because there was an absence of mutual obligations between Park Plaza and the First General Partner.

Second, the court of appeals concluded that the punishments assessed by the trial court were not permitted by statute. Under Section 21.002(b) of the Texas Government Code, the punishment for contempt of court is a fine of not more than \$500, confinement in the county jail for not more than six months, or both such a fine and confinement in jail. The court also cited “longstanding, binding precedent” for the proposition that the only punishments available for criminal contempt are those provided in Section 21.002 and civil damages may not be awarded to a private party as punishment for contempt because such damages are not a fine. Therefore, the court of appeals held that the trial court abused its discretion in punishing Castleman’s contemptuous conduct by assessing an offset against the recovery of three distinct legal entities, none of whom was Castleman or Victory Realty Solutions.

In sum, the court of appeals held that: (1) the Class B Partner became a creditor of the Limited Partnership and was entitled to assert a claim against the Limited Partnership for breach of partnership agreement by failing to pay a distribution owed under section 6.2, even if the partnership agreement did not otherwise impose on the Limited Partnership a duty to make that distribution; and (2) the trial court abused its discretion by reducing the amount of Park Plaza’s recovery against the First General Partner by \$266,400 based on Castleman’s contempt of court.

***Texas First Investment Management Co., LLP v. Coorsh***, No. 01-17-00591-CV, 2018 WL 3352922 (Tex. App.—Houston [1st Dist.] July 10, 2018, no pet.) (mem. op.).

A limited partner sued a limited partnership for breach of contract based on the partnership’s failure to purchase the limited partner’s units after the limited partner exercised a sale option in the partnership agreement. The trial court granted the limited partner’s motion for summary judgment and awarded him actual damages and attorney’s fees. The court of appeals affirmed.

A partnership referred to in the style of the case and the opinion as Texas First Investment Management Company, LLP (“Texas First Investment”) was described in the opinion as a limited partnership formed in 2004. In 2005, Texas First Investment’s limited partners and its general partner, Texas First Fund Holdings, LLC, signed an “Agreement of Limited Partnership of Texas First Investment.” In May 2006, Thomas J. Coorsh became a limited partner of Texas First Investment, purchasing 25,000 partnership units for \$50,000. Coorsh also signed the partnership agreement.

In 2008, Renegade Capital, LP invested in Texas First Investment. It purchased 250,000 partnership units and became a limited partner. As a result, the partnership agreement was amended. Renegade, the other limited partners, including Coorsh, and the general partner signed an “Amended and Restated Agreement of Limited Partnership.” Both the original and the amended partnership agreements included section 9.12, which provided the following:

9.12 Sell Option. On or after the day that is five years from the 17th day of July, 2008, Renegade Capital, L.P. may require, by giving an irrevocable written notice to the Partnership, that the Partnership purchase from such Partner all or some of such Partner's Units or Option Units at the highest value of the following:

- (a) Current fair market value of the collective Units and/or Options Units being purchased; or
- (b) Five Dollars (\$5.00) per Unit or Option Unit.

This right shall come into existence immediately five years from the 17th day of July, 2008 and shall continue indefinitely thereafter. In the event Renegade Capital, L.P. exercises the right granted to it under this Section 9.12, the remaining Limited Partners (specifically excluding, however, Douglas R. Cannon [a limited partner of Texas First Investment]) shall have the right to similarly require the Partnership to purchase that portion of such Partner's Units which is equal to the portion of the Units or Option Units owned by Renegade Capital, L.P. which Renegade Capital, L.P. is requiring the Partnership to purchase. If, upon exercise of this right, the Partnership does not have sufficient surplus to permit it to lawfully purchase all of such Units and/or Option Units, the General Partner shall promptly take such legal measures as may be appropriate or necessary in order to enable the Partnership to lawfully purchase and pay for all such Units and/or Option Units.

On July 17, 2013, Renegade gave written notice to Texas First Investment that it was exercising its option under section 9.12 for Texas First Investment to purchase all of Renegade's 250,000 partnership units. Three days later, Coorsh sent notice to Texas First Investment indicating that he was exercising his option under section 9.12 to sell his 25,000 partnership units to Texas First Investment.

After Coorsh gave his section 9.12 notice, Texas First Investment did not repurchase his partnership units. In December 2015, Coorsh filed suit against (1) Texas First Investment, (2) Renegade, (3) limited partner Douglas Cannon, and (4) general partner Texas First Fund Holdings. Among his claims was breach of contract. Coorsh asserted that he had performed all conditions precedent under the amended partnership agreement, including giving proper notice under section 9.12. Coorsh sought "specific performance of Section 9.12 of the Amended [Partnership] Agreement requiring the Texas First Defendants to purchase his 25,000 units at \$5.00 per unit for a total of \$125,000." The trial court granted Coorsh's motion for partial summary judgment.

On appeal, the court discussed the elements of a breach-of-contract claim and the law of conditions precedent. The court ultimately concluded that, "[b]ased on his summary-judgment evidence, Coorsh conclusively established that he had satisfied the condition precedent to require Texas First Investment to purchase his partnership units." As the court noted, "[t]he summary-judgment evidence showed that Renegade had timely exercised its right to require Texas First Investment to purchase Renegade's 250,000 partnership units," and section 9.12 then gave Coorsh "the right to similarly require the Partnership to purchase that portion of such Partner's Units which is equal to the portion of the Units or Option Units owned by Renegade Capital, L.P. which Renegade Capital, L.P. is requiring the Partnership to purchase." Because Renegade was requiring Texas First Investment to purchase its 250,000 partnership units, Coorsh properly exercised his right to require Texas First Investment to purchase his 25,000 units—"thereby satisfying the condition precedent and triggering Texas First Investment's obligation to purchase Coorsh's partnership units."

Texas First Investment asserted that Coorsh did not show that the condition precedent contained in section 9.12 had been satisfied because Renegade entered into a settlement with Texas First Investment under which Texas First Investment was no longer required to purchase Renegade's partnership units. The court of appeals was unmoved: "Regardless of whether this would serve to undermine Coorsh's showing that he satisfied the condition precedent, Texas First Investment offered no summary-judgment evidence to support this assertion. Thus, it did not meet its summary-judgment burden to raise a material issue of fact with respect to whether Coorsh satisfied the condition precedent."

Texas First Investment also contended that Coorsh had no legal standing to demand the purchase of his units due to his fraudulent acquisition of his ownership interest in the limited partnership. The court of appeals determined that the argument "conflates the jurisdictional concept of standing with the affirmative defense of fraudulent inducement." The court concluded that Coorsh had standing to assert his breach-of-contract claim, and it then proceeded to discuss the fraudulent inducement defense. The original and amended partnership agreements both included sections 12.14(c) and 12.23(j):

12.14. Representations and Warranties. Each Partner hereby represents and warrants to, and covenants with, each other Partner, effective as of the date of this Agreement, as follows:

...

(c) There are no actions, suits or proceedings pending or, to the knowledge of that Partner, threatened against that Partner and/or any of its Affiliates which, if adversely determined, could materially adversely affect the ability of that Partner or any of its Affiliates to perform any other agreement specifically referred to in this Agreement.

[12.23](j) The representations, warranties, agreements, undertakings, and acknowledgments made by such Limited Partner in this Agreement are made with the intent that they be relied upon by the Partnership in determining his, her [or] its suitability as a Limited Partner and shall survive his, her or its purchase of units. In addition, such Limited Partner undertakes to notify the Partnership immediately of any change in any representation, warranty, or other information relating to such Limited Partner set forth herein.

Texas First Investment contended that sections 12.14(c) and 12.23(j) required Coorsh to disclose his affiliation, as chief financial officer, with Wextrust—a company that, around 2007 and 2008, was subject to an FBI and SEC investigation and was ultimately subject to civil and criminal penalties. Texas First Investment asserted that Coorsh’s representation that there were “no actions, suits or proceedings pending” or threatened against him or any of his “Affiliates” was a false representation. The court of appeals noted, however, that “to be a false representation under the language of Section 12.14(c), Texas First Investment also needed to present evidence demonstrating that such actions, suits, or proceedings ‘could materially adversely affect the ability of [Coorsh] or any of [his] Affiliates to perform any other agreement specifically referred to in this Agreement.’” The court of appeals did not believe that there was a fact issue on this point:

Cannon stated that the federal action “against Wextrust Capital, where Coorsh served as Chief Financial Officer, would have had the adverse effect stated in Section 12.14(c),” but Cannon provided no details identifying what other agreements “specifically referred to” in the Original or Amended Partnership Agreements could no longer be performed by Coorsh or his Affiliates. In other words, Cannon’s affidavit did not supply the underlying facts to support his conclusion that the action against Wextrust “had the adverse effect stated in Section 12.14(c).” Thus, this portion of Cannon’s affidavit is conclusory and is not competent summary-judgment evidence to show that Coorsh made a false statement to Texas First Investment. Texas First Investment has not shown that there is a genuine issue of material fact with regard to the first element of fraudulent inducement.

We note that Cannon also testified in his affidavit that, had Texas First Investment known about the federal action against Wextrust, it never would have permitted him to be an investor because “Coorsh was clearly unsuitable to be an investor in and part-owner of a Registered Investment Advisor.” However, Cannon also did not provide any further explanation for the basis of this conclusion.

Moreover, Texas First Investment presented no evidence regarding the last element of fraudulent inducement; that is, it did not show that Coorsh’s nondisclosure of the federal action against Wextrust injured Texas First Investment. As Coorsh points out, the evidence shows that Texas First Investment has had the benefit of Coorsh’s \$50,000 investment since 2006 but offered no evidence to show that the nondisclosure caused it any injury.

We conclude that Texas First Investment did not meet its summary-judgment burden of raising a genuine issue of material fact regarding each element of the affirmative defense of fraudulent inducement, and we overrule its first issue. We hold that Texas First Investment has not shown that the trial court erred in granting summary-judgment in Coorsh’s favor.

*Chapman v. Arfeen*, No. 09-16-00272-CV, 2018 WL 4139001 (Tex. App.—Beaumont Aug. 30, 2018, pet. denied) (mem. op.).

Joe Chapman appealed a summary judgment order that rejected his request for a declaratory judgment about his ownership interests in limited partnerships and dismissed his claims against defendants for breach of fiduciary duty and other actions. The court of appeals affirmed in part and reversed in part.

Chapman owned limited partner interests in various Harbor Hospice limited partnerships. He alleged that after he resigned from his employment, he was told that he was no longer a limited partner and that his limited partner interests had been converted into profit interests. To support their position that Chapman's ownership interests were voluntarily converted into "profit interests paid out as bonuses," Defendants relied upon documentary evidence in the form of assignments and redemption agreements, as well as Chapman's ratification of such agreements by accepting, without objection, periodic "bonus profit payments." The court of appeals found that the trial court erred in granting summary judgment against Chapman on this claim, as there were genuine issues of material fact and problems with an affidavit relied upon by the defendants.

The defendants also claimed that the statute of limitations barred Chapman's claims because he was aware of the transfers or assignments of his ownership interests for more than four years before he sued. The court noted that Chapman's request for declaratory judgment and his claims for breach of the partnership agreement and breach of fiduciary duty were governed by a four-year limitations period. The court observed that, even though Chapman indicated that he did not review his K-1s when he received them, he was deemed to have constructive notice of the changes they reflected to his ownership interests. This was because "[w]hen an individual signs a Form 1040 when filing their income tax with the IRS, they are signing '[u]nder penalties of perjury' that the signor has 'examined this return and accompanying schedules and statements, and to the best of [their] knowledge and belief, they are true, correct[.]'" Nevertheless, after a lengthy discussion, the court concluded that Defendants failed to conclusively establish that the statute of limitations barred Chapman's four-year claims (although limitations did bar Chapman's two-year claims for conversion and theft). The court also concluded that genuine issues of material fact existed on the assertion that Chapman had ratified the transfer of his ownership interests into profit interests.

Chapman also argued that he was verbally promised a 2% limited partner interest in 39 related entities. The 39 entities raised a statute-of-frauds defense, claiming that an oral agreement which is not to be performed within one year from the date of making the agreement is unenforceable. The court referenced the 99-year term of the partnerships (which was stated in the partnership agreements) and concluded that the statute-of-frauds defense was valid:

Based on the language in the agreements, the agreements did not contemplate that the undertaking would be completed within a year. Additionally, even Chapman's account that they would be partners and work together for years does not indicate that the alleged promise could be completed within a year. Finally, a large number of the Thirty-Nine Entities did not come into existence until after 2006. We conclude the agreement concerned an undertaking that could not be completed within a year. Because the statute of frauds applies to the alleged promise regarding the Thirty-Nine Entities, the oral promise, unaccompanied with a written document, is unenforceable.

The court also reaffirmed that the statute of frauds applies to partnerships:

Chapman also argues that the statute of frauds does not apply to the partnerships in his case. We disagree. Relying on *Citrin Holdings, LLC v. Minnis*, No. 14-11-00644-CV, 2013 WL 1928652 (Tex. App.—Houston [14th Dist.] May 9, 2013, pet. denied), Chapman contends that the statute of frauds does not apply to his claims because he raised a fact issue as to whether he established a statutory partnership as provided by section 152.052(a) of the Texas Business Organizations Code. However, *Citrin Holdings* does not hold that section 152.052 provides an exception to the application of the statute of frauds for partnerships; but rather, that the statute of frauds does not prevent a plaintiff from seeking recovery of his out-of-pocket damages because he relied upon an oral promise. Chapman did not complain in the trial court or on appeal that the alleged oral promise to be partners with Arfeen in all future Harbor entities resulted in him suffering out-of-pocket damages. We overrule Chapman's claims that the statute of frauds does not apply to the Thirty-Nine Entities to which he claims he has an ownership interest.

Chapman argued that promissory estoppel was an exception to the statute of frauds, and the court agreed. He asserted that his reliance on the alleged oral agreement was evidenced by the fact that he continued to work for the partnerships and assisted them in return for his promised ownership interests. The court rejected the argument, however, as it observed that Chapman was compensated for his work. As a result, he “[could not] rely on the fact [that] he continued to work to raise a fact issue on his promissory estoppel claim.”

## 2. Contractual Modification of Fiduciary Duties

*Cruz v. Ghani*, No. 05-17-00566-CV, 2018 WL 6566642 (Tex. App.—Dallas Dec. 13, 2018, pet. filed) (mem. op.).

The court of appeals affirmed the trial court’s judgment in part and reversed the judgment in part on various claims, including breach of fiduciary duty.

The lawsuit involved two medical imaging centers, North Dallas Medical Imaging, LP (“NDMI”) and Plano AMI, LP. The general partner of NDMI was MCG Group, Inc. (“MCG”), and the general partner of Plano AMI was Ghani Medical Investments, Inc. (“GMI”). Appellant Dr. Erwin Cruz was involved in the formation of both businesses with appellee Mehrdad Ghani. After NDMI was dissolved and Cruz was expelled from Plano AMI, he filed a lawsuit in his own name and on behalf of the Erwin A. Cruz Family Limited Partnership, NDMI, Plano AMI, and GMI (collectively as appellants, “Cruz”). Following a multi-day trial, the jury resolved most questions in Cruz’s favor and awarded actual and punitive damages. The trial court, however, granted Ghani’s motion for JNOV and entered judgment for Ghani on all claims.

The jury found that Ghani failed to comply with his fiduciary duties to NDMI with respect to the dissolution of NDMI. (Ghani appeared to have some sort of management role in MCG.) On appeal, the court noted that the jury charge stated that MCG owed fiduciary duties as the general partner of NDMI, and “[t]o the extent Ghani exercised a degree of control over MCG such that he directed MCG’s conduct as the general partner regarding the dissolution of NDMI, Ghani owed fiduciary duties to NDMI.” The court of appeals concluded that there was some evidence to support the jury’s answer that Ghani failed to comply with his fiduciary duties to NDMI:

Although Ghani provided an explanation about why NDMI needed to be dissolved and why the dissolution was not a breach of his fiduciary duties, evidence presented at trial allowed jurors to reach the opposite conclusion. Some evidence shows Ghani withheld financial information from Cruz immediately before seeking Cruz’s consent to close the business. That information would have shown NDMI was not in financial straits and could continue operating as a profitable entity. Although Ghani stated the financial problems were due, in part, to declining reimbursement rates, Hakala [Cruz’s damages expert] testified that occurred in 2006-2007 and the businesses had recovered financially. Further, although Ghani asserted referrals were declining because [referring physicians] were moving their practices away from Dallas, Hakala testified a change would have “some, but not that much” impact on future financial viability and Cruz stated the impact would be minimal.

A jury could reasonably infer that Ghani acted as he did because he no longer wanted to be in business with Cruz and wanted to pursue an opportunity with [his friend Reza] Nabavi. To accomplish this goal, Ghani falsely told Cruz there was “no money coming in, and we have big debt” to scare him into agreeing to close NDMI. Even as Ghani testified he was concerned about reimbursement rates going down and the medical imaging industry becoming less profitable, he formed a new MRI entity with Nabavi to invest in and pursue opportunities in the same industry and in the same geographic area. Based on the contradictory evidence, the jury could have disregarded Ghani’s explanation in favor of the one provided by Cruz.

This is some evidence Ghani placed his own interests before the interests of NDMI, used the advantage of his position to gain a benefit for himself at the expense of NDMI, or placed himself in a position where his self-interest might conflict with his obligations to NDMI. Thus, we conclude there is some evidence to support the jury’s answer to Question 1 that Ghani failed to comply with his fiduciary duties to NDMI. . . . Because more than a scintilla of competent evidence supports the jury’s answers . . . we conclude the trial court erred by disregarding the jury’s answers and entering JNOV in Ghani’s favor . . . .

The jury also found that Ghani failed to comply with his fiduciary duties to Plano AMI and GMI with respect to Ghani's pursuit of another medical imaging business ("Plano Open"). (Ghani was an officer/director of GMI.) On appeal, the court noted that the jury charge stated that GMI owed fiduciary duties to Plano AMI as its general partner, and that Ghani also owed fiduciary duties "to the extent Ghani exercised a degree of control over GMI such that he directed GMI's conduct as a general partner regarding the pursuit of Plano Open." The court also noted that Ghani's motion for JNOV did not challenge that he owed a fiduciary duty to Plano AMI and GMI.

Ghani argued that the Plano AMI partnership agreement allowed him to pursue Plano Open and to compete with Plano AMI. In particular, paragraph 6.1(f) stated the following:

(f) Outside Activities and Conflicts of Interest. The General Partner or any Affiliate thereof and any director, officer, employee, agent, or representative of the General Partner or any Affiliate thereof shall be entitled to and may have business interests and engage in business activities in addition to those relating to the Partnership, including business interests and activities in direct competition with the Partnership. Neither the Partnership nor any of the Partners shall have any rights by virtue of this Agreement or the partnership relationship created hereby in any business ventures of the General Partner, any Affiliate thereof, or any director, officer, employee, agent, or representative of either the General Partner or any affiliate thereof.

After examining various provisions from Chapters 152 and 153 of the Texas Business Organizations Code, the court of appeals agreed that Ghani had not breached his fiduciary duty to Plano AMI:

Here, paragraph 6.1(f) of the Plano AMI Agreement expressly permitted GMI or any of its directors, officers, employees, agents, or representatives to "engage in business activities in addition to those relating to the Partnership, including business interests and activities in direct competition with the Partnership." Through paragraph 6.1(f), the Plano AMI Agreement identified a specific type of activity or category of activities that do not violate the duty of loyalty. *See* TEX. BUS. ORGS. CODE ANN. § 152.002(b)(2). Cruz does not argue the type of activity or category of activities identified in paragraph 6.1(f) are manifestly unreasonable. *See id.* We will honor the contractual terms the parties used to define the scope of their obligations and agreements, including limiting fiduciary duties that might otherwise exist.

Ghani, an officer or director of GMI, pursued Plano Open, which was a business interest in direct competition with Plano AMI. The parties, through the Plano AMI Agreement, expressly allowed Ghani to engage in a business in direct competition with Plano AMI. Because Ghani's actions about which Cruz complains were expressly permitted by the Plano AMI Agreement, we conclude the express limitation of fiduciary duties in the Plano AMI Agreement forecloses Cruz's Plano Open claim. Therefore, we conclude the trial court did not err by granting Ghani's motion for JNOV on [this question].

With respect to Ghani's fiduciary duty to GMI, however, the court found that there was some evidence of a breach:

Cruz, Ghani, and Taba [another doctor] discussed acquiring an open MRI machine to create an additional revenue stream for Plano AMI. Although the parties would have needed to lease additional space to add another machine, some evidence shows the open MRI could have been added to the existing business. Instead of pursuing the open MRI opportunity through GMI, Ghani and Taba created a new entity, GMI # 2. For Ghani and Taba, because the open MRI machine was not expensive and margins were high, the venture was profitable. This is some evidence Ghani placed his own interests before the interests of GMI or placed himself in a position where his self-interest might conflict with his obligations to GMI. Thus, we conclude there is some evidence to support the jury's answer to Question 5A that Ghani failed to comply with his fiduciary duties to GMI.



In a footnote, the court commented: “We do not conclude Ghani was required to use GMI as the general partner for the new open MRI entity as a matter of law. We only conclude that, in light of the jury charge as given, Ghani did not show he complied with his fiduciary obligations to GMI.”

The parties also disputed the ownership structure of GMI and Plano AMI. Cruz maintained that he was a limited partner in Plano AMI and that he held stock in GMI. Ghani asserted that Cruz only owned stock in GMI. The court of appeals concluded that some evidence showed that Cruz was a limited partner in Plano AMI, owned stock in GMI, and that Ghani directed or participated in the conversion of both interests.

A separate jury question found that Ghani failed to comply with his fiduciary duties to NDMI by paying legal fees on behalf of his wife (Rona), who had been sued for work that she performed for NDMI. Cruz argued that Ghani breached his fiduciary duties by not causing NDMI to seek indemnification from Rona. The court of appeals disagreed, and upheld the JNOV for Ghani on this question:

When a party seeking indemnity, as Cruz argues NDMI should have, settles the claim of the potential indemnitor (Rona) without a judicial determination of the indemnitor’s liability to the plaintiff (Ault), the party “must satisfy three elements in order to be entitled to indemnity: 1) that it was potentially liable to the plaintiffs; 2) that the settlement was made in good faith; and 3) that the settlement was a reasonable amount under the circumstances.” *Id.* at \*5 (citing *St. Anthony’s Hosp. v. Whitfield*, 946 S.W.2d 174, 179–80 (Tex. App.—Amarillo 1997, writ denied)). Upon such a showing, the indemnitee may recover the amount paid in settlement of the claim. *Id.* (citing *St. Anthony’s Hosp.*, 946 S.W.2d at 179–80).

There was no judicial determination of Rona’s liability to Ault. There is no evidence . . . in this record showing NDMI could have met the three elements listed above that are required to be entitled to indemnity. Even if we assume NDMI was potentially liable to Ault, there is no evidence the settlement was made in good faith or the amount of the settlement was reasonable.

Because we conclude there is no evidence NDMI was entitled to indemnification against Rona, we also conclude there is no evidence Ghani breached his fiduciary duty by not seeking that indemnification. Additionally, the jury’s finding that Ghani breached his fiduciary duty by not seeking indemnification from Rona is against the great weight and preponderance of the evidence.

Another jury question found that Ghani breached his fiduciary duty to Plano AMI by paying a salary to himself. Ghani did not move for JNOV on the liability question and, therefore, did not challenge this finding. The trial court did not award damages to Cruz on this claim, however, and Cruz argued on appeal that the trial court should have ordered disgorgement of Ghani’s compensation. The court began by discussing the law related to disgorgement:

Courts may fashion equitable remedies such as disgorgement and forfeiture to remedy a breach of a fiduciary duty. Disgorgement is an equitable forfeiture of benefits wrongfully obtained. A party may be required to forfeit benefits when a person rendering services to another in a relationship of trust breaches that trust. *See In re Longview Energy Co.*, 464 S.W.3d 361.

“We have said that such equitable forfeiture ‘is not mainly compensatory . . . nor is it mainly punitive’ and ‘cannot . . . be measured by . . . actual damages.’” *Id.* (quoting *Burrow*, 997 S.W.2d at 240). Disgorgement is compensatory in the same sense attorney fees, interest, and costs are, but it is not damages. As a result, equitable forfeiture is distinguishable from an award of actual damages incurred as a result of a breach of fiduciary duty. A claimant need not prove actual damages to succeed on a claim for forfeiture because they address different wrongs. In addition to serving as a deterrent, forfeiture can serve as restitution to a principal who did not receive the benefit of the bargain due to his agent’s breach of fiduciary duty. However, forfeiture is not justified in every instance in which a fiduciary violates a legal duty because some violations are inadvertent or do not significantly harm the principal.

Whether a forfeiture should be imposed must be determined by the trial court based on the equity of the circumstances. However, certain matters may present fact issues for the jury to decide, such as whether or when the alleged misconduct occurred, the fiduciary’s mental state and culpability, the value of the fiduciary’s services, and the existence and amount of harm to the

principal. Once the factual disputes have been resolved, the trial court must determine: (1) whether the fiduciary's conduct was a "clear and serious" breach of duty to the principal; (2) whether any monetary sum should be forfeited; and (3) if so, what the amount should be.

The court of appeals ultimately concluded that the request for disgorgement should be remanded to the trial court: "Although Cruz, in his sixth amended petition, sought 'disgorgement/fee forfeiture' for Ghani's misconduct and the issue was argued by counsel at the hearing on Ghani's motion for JNOV, the record does not show whether the trial court considered an equitable forfeiture award. Because Cruz requested the remedy and it was timely brought to the trial court's attention, we conclude the request for equitable relief should be remanded to the trial court for consideration of the factors described by the Texas Supreme Court in *ERI Consulting Engineers, Inc. v. Swinnea*, 318 S.W.3d 867, 875 (Tex. 2010)."

***Cohen v. Flat Stone Development Company, Inc.***, Civil Action No. 4:16-CV-00283, 2018 WL 6411410 (S.D. Tex. Oct. 9, 2018).

The court granted summary judgment in favor of the general partner of several limited partnerships on claims for breach of fiduciary duty asserted against the general partner because the limited partnership agreements disclaimed any fiduciary duties owed by the general partner.

In this case involving disputes between the general and limited partners of three limited partnerships, the limited partnership agreements of each of the partnerships contained the following provision:

[T]he General Partner will not owe a fiduciary duty to the Partnership or any Partner. The General Partner will owe a duty of loyalty and a duty of care to the Partnership.

The court stated that "[t]he contract by its plain language distinguishes a fiduciary duty from duties of loyalty and care," and "[f]ailing to give effect to this distinction would fail to 'harmonize and give effect' to both sentences." The court noted by way of footnote that each limited partnership agreement "[a]dditionally, . . . tracks the general meaning of the Texas statute governing the duties of general partners. *See* Tex. Bus. Orgs. Code Ann. § 152.204 (West Supp. 2018)." The court held that the parties intended to disclaim any fiduciary duties, and the court granted summary judgment as to the breach-of-fiduciary-duty claims against the general partner and dismissed those claims.

The court noted that its holding regarding the disclaimer of fiduciary duties did not automatically require dismissal of fraud-by-nondisclosure claims asserted by the limited partners and limited partnerships. The allegations did not state whether the duty of disclosure underlying the fraud-by-nondisclosure claims was based on the existence of a fiduciary relationship or a confidential relationship. Because a duty to disclose may arise from a confidential relationship, dismissal of those claims was not required.

### 3. Removal of Partner

***PNC Bank, N.A. v. 2013 Travis Oak Creek GP, LLC***, 1:17-CV-584-RP, 1:17-CV-560-RP, 2018 WL 6431005 (W.D. Tex. Sep. 28, 2018).

In a dispute regarding the propriety of the removal of the general partner of a limited partnership, the court held that the removal of the general partner was proper under the partnership agreement and dismissed the general partner's claim that its removal breached the partnership agreement.

PNC Bank, N.A. ("PNC"), Columbia Housing Corporation ("Columbia Housing"), and 2013 Oak Creek GP, LLC ("Oak Creek GP") agreed to form a limited partnership to develop a low-income apartment complex in Austin. PNC and Columbia Housing were the original limited partners, and Oak Creek GP was the original general partner. The partnership agreement specified "events of default" upon which the limited partners could remove the general partner.

After construction of the apartment complex was finished and while some minor work was being completed, defects in the exterior structure of the buildings were discovered. Disputes with the general contractor arose leading to a multi-million dollar mechanic's lien being placed on the property and a lawsuit by the general contractor to foreclose the lien. This litigation caused problems in closing the permanent financing, and the limited partners sent a notice of default to Oak Creek GP alleging that it failed to comply with its obligations under the

commitment for permanent financing, caused a default under PNC’s bridge loan as a result, and failed to cure and remove the mechanic’s lien affecting the property. The notice demanded that the defaults be cured by a specified deadline or the limited partners would exercise their right to remove Oak Creek GP as general partner. Eventually, counsel for the limited partners sent a notice of removal to the general partner stating that it had been removed as general partner and that the removal constituted an “event of withdrawal” that required it to relinquish its interest in the partnership to Columbia Housing. A supplemental notice of removal included additional allegations of default under the partnership agreement, including: failure to achieve “Final Construction Completion” by the required deadline; voluntary commencement of receivership proceedings (based on a motion filed in this litigation); and allowing a lawsuit to be filed that could materially and adversely affect the partnership (the litigation filed by the general contractor).

The day after sending notice of removal of the general partner, the partnership, PNC, and Columbia Housing sued Oak Creek GP and related parties alleging various causes of action, and the defendants asserted various counterclaims, including a claim that removal of Oak Creek GP as the general partner breached the partnership agreement. The court agreed with the plaintiffs that the defendants failed to state a claim for breach of contract because the defendants’ answer admitted facts showing that multiple events of default had occurred—such as the fact that the stucco installation required remediation and that the general contractor sued the partnership for non-payment and imposed a lien on the partnership’s apartment complex. The partnership agreement allowed removal of the general partner upon an event of default, and an event of default included failure to achieve “Final Construction Completion” by a specified date. Because “Final Construction Completion” required the general partner to achieve construction or rehabilitation without lien or defect, removal of the general partner for failing to achieve Final Construction Completion was not a breach of the partnership agreement.

*PNC Bank, N.A. v. 2013 Travis Oak Creek GP, LLC*, 1:17-CV-584-RP, 1:17-CV-560-RP, 2018 WL 6433312 (W.D. Tex. Sep. 27, 2018).

The court declined to modify a preliminary injunction or appoint a receiver in this dispute over what entity was the rightful general partner of a limited partnership.

In the aftermath of the removal and replacement of the general partner of a limited partnership, the partnership and its current general and limited partners filed suit against the original general partner and related parties alleging various causes of action and seeking declaratory judgment that the original general partner was replaced by one of the limited partners as the successor general partner. Both sides sought preliminary injunctions, and the court found a substantial likelihood that various events of default (triggering the right to remove the general partner) had occurred, that there was a substantial risk of foreclosure on the property being developed by the partnership, and that the original general partner was removed. The court entered a preliminary injunction prohibiting the defendants from taking any action that interfered with the successor general partner’s exercise of its rights as general partner. In this opinion, the court declined to modify the injunction or appoint a receiver because the defendants did not convince the court that there had been any significant change in circumstances. The court also declined to appoint a receiver because the current preliminary injunction was a less drastic remedy that was adequate to preserve the partnership’s property and manage the partnership.

#### **4. Statute of Frauds**

*Yee v. Anji Technologies, LLC*, No. 05-18-00662-CV, 2019 WL 2120290 (Tex. App.—Dallas May 15, 2019, no pet. h.) (mem. op.).

The court of appeals held that an oral partnership agreement was not enforceable because the agreement could not be performed within one year and the partial performance exception did not apply. However, the would-be partner’s claims for quantum meruit, promissory estoppel, and enforcement of an oral agreement entered into at the time of termination of her employment were not barred.

Wendy Yee was employed by Anji Technologies, LLC (“Anji”) as a senior vice president for several years. After Anji terminated her employment, Yee sued, claiming she was entitled to (1) fifty percent of Anji’s profits from 2012 through 2015 under an oral partnership agreement and (2) fifty percent of Anji’s profits from a certain project under an oral agreement made when her employment was terminated (the “Alcara agreement”). Yee asserted claims for breach of contract, promissory estoppel, breach of fiduciary duty, and quantum meruit. Anji moved for

summary judgment on all of Yee's claims on the ground that the partnership agreement did not comply with the statute of frauds. The trial court granted summary judgment in favor of Anji on all of Yee's claims. The court of appeals affirmed the trial court's summary judgment as to the claims for breach of the partnership agreement and breach of fiduciary duty because the oral partnership agreement was unenforceable under the statute of frauds. The court of appeals reversed the trial court's summary judgment on the claims for quantum meruit, promissory estoppel, and breach of the Alcara agreement because those claims were not barred by the statute of frauds.

The court of appeals concluded that the summary-judgment evidence showed that both Yee and Anji anticipated that the oral partnership agreement—under which Yee would provide certain services, Anji's owner would be responsible for all aspects of software and technical support, and Yee and Anji would split the profits—would take much longer than a year. Anji had been in business five years already, and the purpose of the partnership was to increase Anji's client base and workforce. Yee knew profits were to be reinvested in the partnership, and she had made a personal decision not to seek any distribution of profits for five years. Thus, the court held that Anji met its burden of establishing that the statute of frauds barred Yee's claims for breach of the partnership agreement and breach of fiduciary duties arising from the agreement.

Yee claimed that the partial-performance exception applied in this case, but the court held that she failed to raise a fact issue as to whether work she allegedly performed for no compensation and personal funds she allegedly spent on Anji's costs and expenses were unequivocally referable to the partnership agreement.

Although the partnership agreement was unenforceable based on the statute of frauds, the court of appeals held that Yee's claims for quantum meruit (under which she sought to recover the reasonable value of the goods and services she provided to Anji) and promissory estoppel (under which she sought to recover out-of-pocket expenses) were not barred by the statute of frauds. Thus, the court of appeals reversed the trial court's summary judgment against Yee on those claims.

Additionally, there was nothing about the oral Alcara agreement—which the parties allegedly entered into at the time Yee was terminated and under which Yee would be paid fifty percent of the profits from a project that had just been completed—that would suggest it could not be performed within one year. Thus, Anji should not have been granted summary judgment on that claim.

***Chapman v. Arfeen***, No. 09-16-00272-CV, 2018 WL 4139001 (Tex. App.—Beaumont Aug. 30, 2018, pet. denied) (mem. op.).

Joe Chapman appealed a summary judgment order that rejected his request for a declaratory judgment about his ownership interests in limited partnerships and dismissed his claims against defendants for breach of fiduciary duty and other actions. The court of appeals affirmed in part and reversed in part.

Chapman owned limited partner interests in various Harbor Hospice limited partnerships. He alleged that after he resigned from his employment, he was told that he was no longer a limited partner and that his limited partner interests had been converted into profit interests. To support their position that Chapman's ownership interests were voluntarily converted into "profit interests paid out as bonuses," defendants relied upon documentary evidence in the form of assignments and redemption agreements, as well as Chapman's ratification of such agreements by accepting, without objection, periodic "bonus profit payments." The court of appeals found that the trial court erred in granting summary judgment against Chapman on this claim, as there were genuine issues of material fact and problems with an affidavit relied upon by the defendants.

Chapman argued that he was verbally promised a 2% limited partner interest in 39 related entities. The 39 entities raised a statute-of-fraud defense, claiming that an oral agreement which is not to be performed within one year from the date of making the agreement is unenforceable. The court referenced the 99-year term of the partnerships (which was stated in the partnership agreements) and concluded that the statute-of-fraud defense was valid:

Based on the language in the agreements, the agreements did not contemplate that the undertaking would be completed within a year. Additionally, even Chapman's account that they would be partners and work together for years does not indicate that the alleged promise could be completed within a year. Finally, a large number of the Thirty-Nine Entities did not come into existence until after 2006. We conclude the agreement concerned an undertaking that could not be completed within a year. Because the statute of frauds applies to the alleged promise regarding the Thirty-Nine Entities, the oral promise, unaccompanied with a written document, is unenforceable.

The court also reaffirmed that the statute of frauds applies to partnerships:

Chapman also argues that the statute of frauds does not apply to the partnerships in his case. We disagree. Relying on *Citrin Holdings, LLC v. Minnis*, No. 14-11-00644-CV, 2013 WL 1928652 (Tex. App.—Houston [14th Dist.] May 9, 2013, pet. denied), Chapman contends that the statute of frauds does not apply to his claims because he raised a fact issue as to whether he established a statutory partnership as provided by section 152.052(a) of the Texas Business Organizations Code. However, *Citrin Holdings* does not hold that section 152.052 provides an exception to the application of the statute of frauds for partnerships; but rather, that the statute of frauds does not prevent a plaintiff from seeking recovery of his out-of-pocket damages because he relied upon an oral promise. Chapman did not complain in the trial court or on appeal that the alleged oral promise to be partners with Arfeen in all future Harbor entities resulted in him suffering out-of-pocket damages. We overrule Chapman’s claims that the statute of frauds does not apply to the Thirty-Nine Entities to which he claims he has an ownership interest.

Chapman argued that promissory estoppel was an exception to the statute of frauds, and the court agreed. He asserted that his reliance on the alleged oral agreement was evidenced by the fact that he continued to work for the partnerships and assisted them in return for his promised ownership interests. The court rejected the argument, however, as it observed that Chapman was compensated for his work. As a result, he “[could not] rely on the fact [that] he continued to work to raise a fact issue on his promissory estoppel claim.”

#### **H. Access to Books and Records**

*Raider Ranch, LP v. Lugano, Ltd.*, 2019 WL 1925378, \_\_ S.W.3d \_\_ (Tex. App.—Amarillo 2019, no pet. h.).

The court of appeals affirmed a declaratory judgment in favor of limited partners on their claim that they had a right to inspect the books and records of the partnership under Tex. Bus. Orgs. Code §§ 3.151, 3.153, 153.551, and 153.552. The trial court’s determination on the merits rendered moot the defendants’ Rule 91a motion to dismiss, and the rule of optional completeness did not require the plaintiff to attach to its petition an amendment to the partnership agreement containing release language that the defendants argued relinquished the limited partners’ right to inspect the partnership’s books and records. The court of appeals stated that release is an affirmative defense for which the defendants bore the burden of proof at trial, and the record did not indicate that evidence of a release was admitted. Additionally, the defendants failed on appeal to reconcile the release language in the amended partnership agreement with the statutory language on which the limited partners relied.

*Marshall v. Ribosome L.P.*, No. 01-18-00108-CV, 2019 WL 2041062 (Tex. App.—Houston [1st Dist.] May 9, 2019, no pet. h.) (mem. op.).

The court held that a limited partner did not have a right to an accounting where the partnership agreement required certain information to be furnished to the limited partner and gave a right of access to books and records but did not provide the right to an accounting. The court pointed out that Tex. Bus. Orgs. Code § 153.105 provides that a limited partner’s rights may be created only by the certificate of formation, partnership agreement, or provisions of the statute, and the court stated that the limited partner did not identify any source conferring the right to an accounting.

The court also rejected the limited partner’s claim that the partnership owed him a fiduciary duty to provide an accounting based on his limited partner status. The limited partner cited no authority for the proposition, and the court stated that it was clear that fiduciary powers or liabilities belonged to the general partner rather than the partnership, citing Tex. Bus. Orgs. Code § 153.152.

## I. Withdrawal or Expulsion of Partner

*PNC Bank, N.A. v. 2013 Travis Oak Creek GP, LLC*, 1:17-CV-584-RP, 1:17-CV-560-RP, 2018 WL 6431005 (W.D. Tex. Sep. 28, 2018).

In a dispute regarding the propriety of the removal of the general partner of a limited partnership, the court held that the removal of the general partner was proper under the partnership agreement and dismissed the general partner's claim that its removal breached the partnership agreement.

PNC Bank, N.A. ("PNC"), Columbia Housing SLP Corporation ("Columbia Housing"), and 2013 Oak Creek GP, LLC ("Oak Creek GP") agreed to form a limited partnership to develop a low-income apartment complex in Austin. PNC and Columbia Housing were the original limited partners, and Oak Creek GP was the original general partner. The partnership agreement specified "events of default" upon which the limited partners could remove the general partner.

After construction of the apartment complex was finished and while some minor work was being completed, defects in the exterior structure of the buildings were discovered, and disputes with the general contractor arose leading to a multi-million dollar mechanic's lien being placed on the property and a lawsuit by the general contractor to foreclose the lien. This litigation caused problems in closing the permanent financing, and the limited partners sent a notice of default to Oak Creek GP alleging that it failed to comply with its obligations under the commitment for permanent financing, caused a default under PNC's bridge loan as a result, and failed to cure and remove the mechanic's lien affecting the property. The notice demanded that the defaults be cured by a specified deadline or the limited partners would exercise their right to remove Oak Creek GP as general partner. Eventually, counsel for the limited partners sent a notice of removal to the general partner stating that it had been removed as general partner and that the removal constituted an "event of withdrawal" that required it to relinquish its interest in the partnership to Columbia Housing. A supplemental notice of removal included additional allegations of default under the partnership agreement, including: failure to achieve "Final Construction Completion" by the required deadline; voluntary commencement of receivership proceedings (based on a motion filed in this litigation); and allowing a lawsuit to be filed that could materially and adversely affect the partnership (the litigation filed by the general contractor).

The day after sending notice of removal of the general partner, the partnership, PNC, and Columbia Housing sued Oak Creek GP and related parties alleging various causes of action, and the defendants asserted various counterclaims, including a claim that removal of Oak Creek GP as the general partner breached the partnership agreement. The court agreed with the plaintiffs that the defendants failed to state a claim for breach of contract because the defendants' answer admitted facts showing that multiple events of default had occurred—such as the fact that the stucco installation required remediation and that the general contractor sued the partnership for non-payment and imposed a lien on the partnership's apartment complex. The partnership agreement allowed removal of the general partner upon an event of default, and an event of default included failure to achieve "Final Construction Completion" by a specified date. Because "Final Construction Completion" required the general partner to achieve construction or rehabilitation without lien or defect, removal of the general partner for failing to achieve Final Construction Completion was not a breach of the partnership agreement.

*PNC Bank, N.A. v. 2013 Travis Oak Creek GP, LLC*, 1:17-CV-584-RP, 1:17-CV-560-RP, 2018 WL 6433312 (W.D. Tex. Sep. 27, 2018).

The court declined to modify a preliminary injunction or to appoint a receiver in this dispute over what entity was the rightful general partner of a limited partnership.

In the aftermath of the removal and replacement of the general partner of a limited partnership, the partnership and its current general and limited partners filed suit against the original general partner and related parties alleging various causes of action and seeking declaratory judgment that the original general partner was replaced by one of the limited partners as the successor general partner. Both sides sought preliminary injunctions, and the court found a substantial likelihood that various events of default (triggering the right to remove the general partner) had occurred, that there was a substantial risk of foreclosure on the property being developed by the partnership, and that the original general partner was removed. The court entered a preliminary injunction prohibiting the defendants from taking any action that interfered with the successor general partner's exercise of its rights as general partner. In this opinion, the court declined to modify the injunction or appoint a receiver because the defendants did not convince the court that there had been any significant change in circumstances. The

court also declined to appoint a receiver because the current preliminary injunction was a less drastic remedy that was adequate to preserve the partnership's property and manage the partnership.

*Strnad v. Behrend*, Civil Action No. SA-07-CV-680-XR, Civil Action No. SA-07-CV-741-XR, 2008 WL 11333897 (W.D. Tex. July 21, 2008). (Although the court issued this opinion in 2008, it is included in this year's update because it did not appear in the Westlaw database until recently.)

The court held that the plaintiff's claims that a partnership existed between the plaintiff and the defendants and for enforcement of rights in connection with the partnership were barred by the statute of limitations where the plaintiff ceased to be involved in the partnership in 1997, knew of his claims at that time, and did not bring the action until 2007.

The plaintiff asserted that he and the defendants were partners in a bail bond business, and the plaintiff asserted a RICO claim and various other claims against the defendants in connection with wrongful acts committed by the defendants relating to the partnership's business and property. The defendants denied that a partnership existed and argued that, even if a partnership existed, the plaintiff's claims were barred by the statute of limitations because the partnership dissolved in 1997. Strnad argued that the partnership continued to the present day because there had been no winding up, relying on Tex. Rev. Civ. Stat. art. 6132b-8.02. It was undisputed that Strnad never spoke to his alleged partners or performed any act related to the partnership after November 7, 1997, and the court stated that Strnad essentially withdrew from the partnership and ceased to be a partner at that time, citing Tex. Rev. Civ. Stat. art. 6132b-8.02 for the proposition that "[a] partner at any time before the occurrence of an event requiring a winding up has the power to withdraw from the partnership and cease to be a partner." The court then held that Strnad's claims were barred by limitations based on the following reasoning:

Even taking in account that Strnad may have had good cause for his departure from the alleged partnership (being shot at by his alleged partner), there is no adequate explanation offered for Strnad's delay in exercising any of his partnership rights. Strnad waited until August 16, 2007 to file this suit. Apparently, he conscientiously decided not to pursue any claims because he and his lawyer thought the Defendants were insolvent and that the IRS got everything. Alternatively, Strnad also states in an affidavit that he didn't realize he was in a partnership because he erroneously thought that a formal written agreement was necessary. In other portions of the summary judgment evidence tendered in these cases, Strnad appears to have known that Behrend was calling him a partner before 1997. These grounds do not constitute the basis for any equitable tolling.

Although the court acknowledged that the actions of Strnad's alleged partners were quite confusing, the fact remained that if a partnership existed the "arrangement ended in 1997 and Strnad failed to timely exercise any rights he may have possessed." Thus, the RICO claims were barred by limitations and "Strnad's implied partnership claim and request for a constructive trust" were barred by the limitations period set forth in Tex. Civ. Prac. & Rem. Code § 16.004(c) ("A person must bring suit against his partner for a settlement of partnership accounts . . . not later than four years after the day that the cause of action accrues. For purposes of this subsection, the cause of action accrues on the day that the dealings in which the parties were interested together cease."). Because any claims to partnership rights were barred by limitations, the court denied several other types of relief that Strnad argued were necessary to wind up the partnership and dispose of its property.

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

*United States v. Catholic Health Initiatives*, 312 F. Supp. 3d 584 (S.D. Tex. 2018).

Three physician investors in a hospital structured as a limited liability partnership brought a *qui tam* action under the False Claims Act, alleging that the rescission process used by the partnership under the Texas Securities Act to buy out the Class A physician partners violated the Anti-Kickback Statute, the Stark law, and the False Claims Act and that misrepresentations about the ownership of the hospital in the context of winding up the partnership led to violations of the False Claims Act and Texas Medicaid Fraud Prevention Act. Acknowledging that the relators may have legitimate grievances, the court dismissed the suit, stating that "the 'False Claims Act

is not an all-purpose antifraud statute or a vehicle for punishing garden variety breaches of contract or regulatory violations . . . . More is needed to establish that false or fraudulent claims have been made on the government.”

*Strnad v. Behrend*, Civil Action No. SA-07-CV-680-XR, Civil Action No. SA-07-CV-741-XR, 2008 WL 11333897 (W.D. Tex. July 21, 2008). (Although the court issued this opinion in 2008, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court held that the plaintiff’s claims that a partnership existed between the plaintiff and the defendants and for enforcement of rights in connection with the partnership were barred by the statute of limitations where the plaintiff ceased to be involved in the partnership in 1997, knew of his claims at that time, and did not bring the action until 2007.

The plaintiff asserted that he and the defendants were partners in a bail bond business, and the plaintiff asserted a RICO claim and various other claims against the defendants in connection with wrongful acts committed by the defendants relating to the partnership’s business and property. The defendants denied that a partnership existed and argued that, even if a partnership existed, the plaintiff’s claims were barred by the statute of limitations because the partnership dissolved in 1997. Strnad argued that the partnership continued to the present day because there had been no winding up, relying on Tex. Rev. Civ. Stat. art. 6132b-8.02. It was undisputed that Strnad never spoke to his alleged partners or performed any act related to the partnership after November 7, 1997, and the court stated that Strnad essentially withdrew from the partnership and ceased to be a partner at that time. The court then held that Strnad’s claims were barred by limitations based on the following reasoning:

Even taking in account that Strnad may have had good cause for his departure from the alleged partnership (being shot at by his alleged partner), there is no adequate explanation offered for Strnad’s delay in exercising any of his partnership rights. Strnad waited until August 16, 2007 to file this suit. Apparently, he conscientiously decided not to pursue any claims because he and his lawyer thought the Defendants were insolvent and that the IRS got everything. Alternatively, Strnad also states in an affidavit that he didn’t realize he was in a partnership because he erroneously thought that a formal written agreement was necessary. In other portions of the summary judgment evidence tendered in these cases, Strnad appears to have known that Behrend was calling him a partner before 1997. These grounds do not constitute the basis for any equitable tolling.

Although the court acknowledged that the actions of Strnad’s alleged partners were quite confusing, the fact remained that if a partnership existed the “arrangement ended in 1997 and Strnad failed to timely exercise any rights he may have possessed.” Thus, the RICO claims were barred by limitations and “Strnad’s implied partnership claim and request for a constructive trust” were barred by the limitations period set forth in Tex. Civ. Prac. & Rem. Code § 16.004(c) (“A person must bring suit against his partner for a settlement of partnership accounts . . . not later than four years after the day that the cause of action accrues. For purposes of this subsection, the cause of action accrues on the day that the dealings in which the parties were interested together cease.”). Because any claims to partnership rights were barred by limitations, the court denied several other types of relief that Strnad argued were necessary to wind up the partnership and dispose of its property.

#### **K. Piercing Partnership Veil**

*Pierce v. Fondren Orthopedic Group, LLP*, Civ. A. No. H-18-1686, 2018 WL 6200049 (S.D. Tex. Nov. 28, 2018).

The court denied (a) Peggy Pierce’s and Fondren Orthopedic, Ltd.’s (“FOLTD”) cross-motions for summary judgment on a breach-of-contract claim, and (b) Snow Goose Corporation’s motion to intervene.

FOLTD was a Texas limited partnership formed for the purpose of investing in a hospital. The general partner of FOLTD was Snow Goose Corporation. In the breach-of-contract claim before the court, Pierce alleged that FOLTD had breached an agreement which allegedly obligated it to pay Pierce for five years after her termination from a FOLTD affiliate. The agreement was signed by Dr. G. William Woods, M.D. in his capacity as the President of Snow Goose.



The court concluded that the agreement was supported by consideration and did not excuse FOLTD's performance in the event of a for-cause termination. The court then engaged in a lengthy discussion of whether Woods had actual or apparent authority to act on behalf of Snow Goose. FOLTD argued in part that Woods lacked actual authority to enter into the agreement because Pierce was an officer of Snow Goose, and the Snow Goose bylaws apparently required contracts between Snow Goose and Snow Goose officers to be approved by the Snow Goose board of directors. The court rejected the argument:

Plaintiff argues that her status as a Snow Goose officer is irrelevant to the enforceability of the Agreement because the Agreement was executed between Plaintiff and FOLTD, not Plaintiff and Snow Goose. The court agrees. The Agreement is between Plaintiff and FOLTD and has nothing to do with Plaintiff's involvement in the management of Snow Goose. The court is therefore not persuaded by Defendants' arguments that the Agreement required approval of the Snow Goose Board because of Plaintiff's alleged status as an officer of Snow Goose.

The court is also not persuaded by Defendants' argument that because Snow Goose is FOLTD's general partner, all FOLTD contracts are necessarily Snow Goose contracts. In its Cross-[Motion for Partial Summary Judgment], FOLTD cites *Peterson Group, Inc. v. PLTQ Lotus Group, L.P.*, 417 S.W.3d 46 (Tex. App.—Houston [1st Dist.] 2013, pet. denied), and *Pinebrook Properties, Ltd. v. Brookhaven Lake Property Owners Ass'n*, 77 S.W.3d 487 (Tex. App.—Texarkana 2002, pet. denied), in support of its argument that Texas law considers limited partnerships to be “one and the same” with their general partners. These cases merely held that the doctrine of alter ego does not apply to the general partners of limited partnerships because there is no need to “veil pierce” in order to hold general partners liable—general partners are already jointly and severally liable on partnership obligations. *Peterson Group*, 417 S.W.3d at 57; *Pinebrook Properties*, 77 S.W.3d at 499-500. The fact that Snow Goose could ultimately be held liable on one of FOLTD's obligations does not mean that Snow Goose was a party to all of FOLTD's contracts. The Agreement was between Plaintiff and FOLTD; it did not purport to create a Snow Goose obligation. The Agreement did not need to conform to the requirements of the Snow Goose Bylaws or Texas law regarding contracts between corporate officers and corporations.

The court ultimately determined, however, that fact questions on actual and apparent authority precluded the grant of summary judgment for any of the parties.

In rejecting Snow Goose's motion to intervene, the court stated that “[m]erely because Snow Goose was FOLTD's general partner and Snow Goose acted as FOLTD's signatory does not make Snow Goose a party to the Agreement.” The court concluded that the interests of Snow Goose were adequately represented by FOLTD because the Agreement was between Pierce and FOLTD.

***Ball Up, LLC v. Strategic Partners Corp.***, No. 02-17-00197-CV, No. 02-17-00198-CV, 2018 WL 3673044 (Tex. App.—Fort Worth Aug. 2, 2018, no pet.) (mem. op.).

The court of appeals affirmed the trial court's orders granting the special appearances of an individual, a Delaware LLC, and a Delaware limited partnership, and reversed the trial court's denial of a Delaware corporation's special appearance.

Ball Up, LLC (Texas LLC) sued various defendants for misrepresentation and conspiracy: Mike Singer individually (CEO of Strategic Distribution, LP); Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC. These three entity defendants made general appearances. Ball Up also named as defendants Strategic Partners Corp. (Delaware corporation); PG-ACP Holdings, L.P. (Delaware limited partnership); PG-ACP Holdings GP, LLC (Delaware LLC); and Strategic Partners Acquisition Corp. (Delaware corporation) (“SPAC”). After a hearing, the trial court signed orders and amended orders sustaining special appearances filed by Singer individually and the Appellee Entities—Strategic Partners Corp.; PG-ACP Holdings, L.P.; and PG-ACP Holdings GP, LLC. The trial court denied the special appearance filed by SPAC. The court of appeals referred to the generally appearing defendants, the Appellee Entities, and SPAC collectively as the “SP Companies.”

On appeal, Ball Up challenged the trial court's orders sustaining the special appearances of Singer and the Appellee Entities. SPAC similarly challenged the denial of its special appearance. Ball Up's challenge was based in part on an argument that the Texas contacts of some of the generally appearing defendants could be imputed to

Singer, the Appellee Entities, and SPAC on piercing grounds. In discussing the law of personal jurisdiction based on a piercing theory, the court of appeals observed:

Concerning allegations of personal jurisdiction over a defendant based on the alter-ego theory, personal jurisdiction may exist over a nonresident defendant if the relationship between the foreign corporation and its parent corporation that does business in Texas is one that would allow the court to impute the parent corporation's "doing business" to the subsidiary. *BMC Software Belg., N.V.*, 83 S.W.3d at 798–99. The rationale for exercising alter-ego personal jurisdiction is that "the parent corporation exerts such domination and control over its subsidiary 'that they do not in reality constitute separate and distinct corporate entities but are one and the same corporation for purposes of jurisdiction.'" *Id.* (quoting *Hargrave v. Fibreboard Corp.*, 710 F.2d 1154, 1159 (5th Cir. 1983)). The party seeking to ascribe one corporation's actions to another by disregarding their distinct corporate entities must prove this allegation because Texas law presumes that two separate corporations are indeed distinct entities. *Id.*

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 and that the degree of control the parent exercises is 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 proof required of a party seeking to fuse a parent company and a subsidiary company for jurisdictional veil-piercing purposes is different and more strenuous than the proof required of a party seeking to fuse a parent and a subsidiary company for substantive veil-piercing purposes. . . .

Because Texas law presumes that two separate corporations are distinct entities, Ball Up, as the party seeking to ascribe the actions of some of the SP Companies to other of the SP Companies for jurisdictional purposes by piercing the corporate veil, bore the burden of proving an alter-ego relationship. Absent proof by Ball Up establishing a factual basis for some legal theory, such as alter-ego or single-business enterprise, to attain corporate veil piercing that will support the aggregation of acts or contacts by separate legal entities, they will not be aggregated. That is, Ball Up's pleadings and briefing relating to acts performed by and contacts with the SP Companies (assuming the facts pleaded such contacts and acts occurred in Texas) is nonetheless not sufficient to establish general-jurisdiction minimum contacts or specific committed-a-tort-in-whole-or-in-part-in-Texas jurisdiction unless the acts and contacts Ball Up has attributed to the SP Companies are attributable to one or more of the Appellee Entities, to SPAC, or to Singer under an alter-ego/veil-piercing theory.

The court of appeals ultimately concluded that Ball Up failed to meet its burden of establishing its piercing allegations for jurisdictional purposes:

On appeal, Ball Up does not focus on the purported alter-ego relationship existing between any particular SP Companies or Singer. Instead, Ball Up argues that personal jurisdiction exists under the alter-ego/veil-piercing theory because the SP Companies "cannot prove which company(ies) made the decisions on the Ball Up project, they cannot prove which company(ies) did not make the decisions on the Ball Up Project" and that, therefore, "none of these entities can negate Ball Up's allegations that they were involved in the project." But Ball Up—not the Appellee Entities, SPAC, or Singer—had the burden of pleading and proving an alter-ego/veil-piercing theory in order to attribute contacts with the forum by one defendant to another defendant or to attribute jurisdictional acts by one defendant to another defendant.

Ball Up had the burden to overcome the presumption that two separate business entities are distinct by proving its alter-ego/veil-piercing allegation. To fuse all of the SP Companies for jurisdictional purposes—that is, to make the acts or contacts of the generally-appearing defendants Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC or of other specially-appearing defendants constitute acts or contacts by the Appellee Entities, SPAC, or Singer—Ball Up was required to establish that the Appellee Entities, SPAC, or Singer exercised

a degree of control over Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC that is “greater than that normally associated with common ownership and directorship”; the evidence must show that the Appellee Entities, SPAC, Singer, and the generally-appearing defendants or some combination of these ceased to be separate.

The following factors have been identified as important to determining whether a subsidiary is separate and distinct from its parent corporation for personal jurisdiction purposes: (1) the amount of the subsidiary’s stock owned by the parent corporation, (2) the existence of separate headquarters, (3) the observance of corporate formalities, and (4) the degree of the parent’s control over the general policy and administration of the subsidiary. The types of evidence a court will consider as proof of alter ego—when a person is alleged to be the alter ego of a corporation but also applicable in allegations of entity-to-entity alter ego—include: (1) the payment of alleged corporate debt with personal checks or other commingling of funds; (2) representations that the individual will financially back the corporation; (3) the diversion of company profits to the individual for his personal use; (4) inadequate capitalization; and (5) other failure to keep corporate and personal assets separate.

Ball Up did not offer evidence of financial commingling of funds between any combination of the SP Companies and Singer, the payment of one of the SP Companies’ debt by another or by Singer, the diversion of profits from one SP Company to another or to Singer, the failure to keep separate accounting records or corporate books, a lack of separate legal formation, or other evidence that would establish that the Appellee Entities, SPAC, or Singer exercised a degree of control over Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC that is greater than that normally associated with common ownership and directorship so that the Appellee Entities, SPAC, and the generally-appearing defendants ceased to be separate entities.

The evidence Ball Up did produce with regard to SPAC consisted of two spreadsheets containing SPAC’s name that were provided to Ball Up and that detailed the Ball Up Apparel Project’s expenses. Ball Up argues that these spreadsheets coupled with the alleged failure of the SP Companies to maintain separate and distinct corporate identities is sufficient to support the trial court’s denial of SPAC’s special appearance. We cannot agree. Even if SPAC created the spreadsheet for the project’s current expenses, the two spreadsheets simply represent a calculation of expenses and do not establish any amounts billed by SPAC or work performed by SPAC. Thus, the spreadsheets are insufficient to support a showing that SPAC has the minimum contacts necessary to demonstrate that the trial court has personal jurisdiction over SPAC.

The evidence Ball Up did produce with regard to the Appellee Entities consisted of excerpts from [Robert] Pierpoint’s deposition [an officer of various SP Companies] establishing that the composition of the board of directors of each of the SP Companies was the same or substantially the same; that Padraic McConville worked for Partners Group; that Partners Group was a private equity partner that sat on the board of directors for PG-ACP Holdings, GP; and that McConville put Ball Up proposal numbers together for the PG-ACP Holdings, GP’s board of directors. Ball Up’s evidence and contentions, however, do not rise to the required level of control and domination by one or more of the SP Companies over one or more of the other SP Companies necessary to meet Ball Up’s burden of proving that the SP Companies ceased to be separate entities and are one and the same for jurisdictional purposes. [Ball Up does not specifically identify which of the generally-appearing defendants, the Appellee Entities, or SPAC are purportedly fused for jurisdictional purposes; Ball Up alleges all of them were intertwined and acted jointly.]

Ball Up’s alter-ego/veil-piercing jurisdictional evidence at most shows some common ownership between the SP Companies and some common and overlapping boards of directors; this type of evidence does not establish alter ego for jurisdictional purposes. [If Ball Up had met its burden of proving alter ego, no evidence exists that piercing the corporate veil of any particular entity or entities for purposes of personal jurisdiction is necessary to prevent fraud or injustice.]

Because Ball Up failed to assert or to offer proof of acts by the Appellee Entities, SPAC, and Singer in furtherance of Ball Up’s tort claims against them and also failed to meet its burden of proving its alter-ego/veil-piercing jurisdictional theory concerning the Appellee Entities, SPAC,

and Singer, the trial court properly sustained the Appellee Entities' and Singer's special appearances and erred by denying SPAC's special appearance.

The court also observed: "In addition to factually negating personal jurisdiction, Singer's affidavit and special-appearance evidence legally negated personal jurisdiction; Singer established that at all times in any dealings with Ball Up he was acting in his corporate capacity on behalf of generally-appearing Strategic Distribution. Thus, even if Singer had contacts with Texas or performed acts in Texas—which he directly denied in his affidavit—personal jurisdiction over him could not be predicated on jurisdiction over Strategic Distribution unless Strategic Distribution is the alter ego of Singer."

#### **L. Creditor's Remedies: Charging Order, Turnover Order, etc.**

*Westergren v. Houston Pilots Association*, 566 S.W.3d 7 (Tex. App.—Houston [14th Dist.] Aug. 7, 2018, no pet.) ("Yet, even if Houston Pilots were a general partnership, each individual partner pilot would be jointly and severally liable for a judgment against the partnership. In general, 'all partners are jointly and severally liable for all obligations of the partnership.' Tex. Bus. Orgs. Code § 152.304(a). 'This personal liability, undoubtedly a[ ] . . . feature [of the aggregate theory of partnership], is a defining characteristic of the partnership form and distinguishes it from other entity types.' *Am. Star Energy*, 457 S.W.3d at 429. In addition, a judgment creditor of a general partnership can immediately enforce that judgment by execution against the joint property of the partners and, in some circumstances, can also execute against the individual property of partners without first seeking satisfaction from partnership property. *Id.* at 429-430 & n.2; *see* Tex. Bus. Orgs. Code §§ 152.306(b)-(c). [As with an unincorporated association, a judgment creditor of a partnership cannot execute against the individual property of partners without serving them. Tex. Bus. Orgs. Code § 152.306(a). But the judgment against the partnership generally is conclusive of the individual partners' joint and several liability. *Id.* § 152.304(a).]").

*Allstate Insurance Co. v. Receivable Finance Co.*, Civ. A. No. 3:01-CV-2247-N, 2005 WL 8158032 (N.D. Tex. Oct. 19, 2005). (Although the court issued this opinion in 2005, it is included in this year's update because it did not appear in the Westlaw database until recently.)

Martinez was one of several defendants found jointly and severally liable to Allstate for a judgment in the amount of \$2,750,000. Allstate sought a turnover order against Martinez under § 31.002 of the Texas Civil Practice and Remedies Code. The court found that Allstate was entitled to relief under the turnover statute because Allstate demonstrated that Martinez owned nonexempt property that could not be readily attached or levied on by ordinary legal process. The court then considered whether a turnover order could reach property that Martinez had transferred to limited partnerships in which he held a partnership interest. The court noted that the Texas Revised Limited Partnership Act governed limited partnerships and permitted a court charging a partnership interest to appoint a receiver and to decree a foreclosure and sale of the charged interest. The court concluded:

The record before the Court reflects that the limited partnership is of such character that distributions to Martinez could not be expected to satisfy the judgment in a reasonable time. Accordingly, the Court finds that execution on Martinez's partnership interest is appropriate. The Court also finds that Martinez owns property that cannot readily be attached or levied on by ordinary legal process, including but not limited to ownership interest[s] in limited partnerships and professional and other corporations that are not exempt from attachment, execution, or seizure for the satisfaction of liabilities. The Court thus finds that Allstate is entitled to appointment of a receiver under the turnover statute and TRLPA [Texas Revised Limited Partnership Act] to take possession of Martinez's nonexempt property and sell it to satisfy Allstate's judgment against Martinez. The Court will by separate Order appoint a receiver under the turnover statute and direct the charging and execution upon any of Martinez' partnership interest.

## **M. Attorney's Fees**

*Al-Saud v. Youtoo Media, L.P.*, 754 Fed. App'x 246 (5th Cir. 2018).

The Fifth Circuit affirmed the district court's judgment of liability for breach of contract and attorney's fees against a general partner of a limited partnership.

Mansour Bin Abdullah Al-Saud made a \$3 million reimbursable down payment to Youtoo Media, L.P. while he considered whether to purchase a stake in the technology company. The parties signed a letter of intent ("LOI") memorializing that Al-Saud would provide \$3 million to Youtoo and that he had three months to decide "in his sole discretion" whether to buy a stake in the company. If he declined to invest, Youtoo would reimburse the down payment. The LOI also provided that Youtoo's "general partner is Chris Wyatt (the 'General Partner')."

Al-Saud ultimately declined to purchase an interest in the company. Youtoo's primary lender eventually forced the company to sell its intellectual property and assets to cover outstanding debts. In light of Youtoo's wind down, Al-Saud asked for his money back. Youtoo rejected his request and asserted that Al-Saud had agreed to be "reimbursed in full" through the first \$3 million in profit distributions from Youtoo's share in a Middle East entity.

Al-Saud sued for breach of contract. The jury found Youtoo and Wyatt liable for breaching the LOI and awarded Al-Saud \$3 million in damages for the down payment that was not returned. Al-Saud was also awarded attorney's fees against Wyatt but not Youtoo.

On appeal, the Fifth Circuit concluded that Wyatt, as general partner of Youtoo, was "derivatively" liable for Youtoo's obligations. (Because the LOI placed the burden of reimbursing Al-Saud's down payment on Youtoo alone, Wyatt was not held "directly" liable for breach of the LOI.) The Fifth Circuit then addressed whether the district court had erred in awarding attorneys' fees against Wyatt. The court noted that under § 38.001 of the Texas Civil Practice and Remedies Code, a party prevailing on a breach-of-contract claim may recover fees from an individual or corporation. Because "[c]ourts have interpreted 'individual' and 'corporation' strictly," the court concluded that "partnerships like Youtoo are not liable for fees." With respect to Wyatt, the court observed that "[i]t might seem anomalous if Wyatt were on the hook for fees when the party with the underlying liability is not," and it noted that "Texas courts have not addressed this situation." Nevertheless, the Fifth Circuit concluded that the text of § 38.001 was clear and "[i]t does not make the recovery of such fees dependent on the theory of liability imposed." As the court observed: "[Section 38.001] looks solely to whether that party is an individual or corporation. Whether Wyatt is derivatively or directly liable, he is still an individual. We will therefore affirm the judgment requiring Wyatt to pay fees for the breach of the LOI."

*J.F. Nut Co., S.A. de C.V. v. San Saba Pecan, LP*, Cause No. A-17-CV-00405-SS, 2018 WL 7286493 (W.D. Tex. July 23, 2018) (granting summary judgment in favor of limited partnership with respect to plaintiff's claim for attorney's fees because "Texas courts have consistently held § 38.001 does not apply to limited partnerships").

*Phoneternet, LLC v. Drawbridge Design*, No. 05-17-00890-CV, 2018 WL 3238001 (Tex. App.—Dallas July 3, 2018, no pet.) (mem. op.).

"Section 38.001 of the Texas Civil Practice and Remedies Code authorizes an award of attorneys' fees for certain enumerated classes of claims brought by a 'person' against 'an individual or corporation.' Under the plain language of section 38.001, a trial court cannot order limited liability partnerships (L.L.P.), limited liability companies (L.L.C.), or limited partnerships (L.P.) to pay attorneys' fees. . . . In their second issue, appellants argue 'limited liability companies such as Phoneternet, LLC cannot be held liable for attorney fees' and therefore they 'request[ ] the court set aside the award of fees against [Phoneternet LLC].' Drawbridge Design does not dispute that Phoneternet L.L.C. is a limited liability company. Rather, it argues that because the court 'awarded fees against both the LLC and Alfia [an individual], jointly and severally' the trial court 'did not act unreasonably when entering judgment for attorneys' fees against both [a]ppellants.' However, Drawbridge Design does not cite any case law to support its contention and we find none. We conclude section 38.001 of the Texas Civil Practice and Remedies Code does not permit recovery of attorney fees against a limited liability company. The trial court erred in awarding attorney's fees against Phoneternet, L.L.C."

*Ugwu v. Ugwu*, No. 05–16–01116–CV, 2018 WL 2715405 (Tex. App.—Dallas June 6, 2018, no pet.) (mem. op.).

The court upheld an award of attorney’s fees to one partner against the other partner for breach of the partnership agreement under Tex. Civ. Prac. & Rem. Code § 38.001 because the partner recovered damages for a breach-of-contract claim.

#### N. Standing or Capacity to Sue

*United States for Use and Benefit of PBT and JBJ Alliance v. Frankenmuth Mutual Insurance Company*, Civil Action No. 3:18-CV-2785-B, 2019 WL 1979362 (N.D. Tex. May 3, 2019).

In a suit to recover under a subcontract brought by the party that was named in the contract, the court dismissed as a plaintiff a party who was not named in the contract but claimed to be one of two joint venturers comprising the named party. The court stated that the plaintiff who was not a named party did not have the right to pursue the action in its own name without joining the other partner. The plaintiffs could either amend and add the other partner as a plaintiff or sue only in the name of the partnership.

PBT and JBJ Alliance (the “Alliance”) and JBJ Restoration, LLC (“JBJ LLC”) sued on a subcontract entered into in the name of the Alliance. The defendant argued that JBJ LLC lacked any contractual relationship with it and did not have standing to sue. The plaintiffs claimed that the Alliance was an unincorporated association of two companies—a joint venture between JBJ LLC and Purple Building Technologies, Inc. (“PBT Inc.”). Plaintiffs argued that JBJ LLC, as a member of the joint venture, was one of the two real parties in interest and that its claims were one and the same as those of the Alliance’s such that joinder of JBJ LLC was proper. The court stated that the ability of parties who are not individuals or corporations to sue in federal court is determined by state law, and the court explained Texas law as follows:

Generally, under Texas law, a joint venture is governed by the rules applicable to partnerships. *Smith v. Deneve*, 285 S.W.3d 904, 913 (Tex. App.—Dallas 2009, no pet.). Under Texas partnership law, a partnership is “an entity distinct from its partners.” *Am. Star Energy & Minerals Corp. v. Stowers*, 457 S.W.3d 427, 429 (Tex. 2015). “As an independent entity, a partnership may enter into contracts in its own name, may own its own property, and may sue and be sued in its own name.” *Id.* The general rule is that “a partnership cause of action belongs to and is the specific property of the partnership” and a partner may not “bring suit either on such a cause of action as a whole, whether in the name of the partnership or in [its] own name, or for the fractional share of such a cause of action corresponding to [its] fractional interest in the partnership.” *Cates v. Int’l Tel. & Tel. Corp.*, 756 F.2d 1161, 1176 (5th Cir. 1985). However, an exception to this general rule allows partners to bring a suit individually based on a contract made on behalf of the partnership if all partners are made parties to the suit. *See id.*; *see also Chien v. Chen*, 759 S.W.2d 484, 490–91 (Tex. App.—Austin 1988, no pet.).

Thus, although the contract was entered into in the name the Alliance, JBJ LLC and PBT Inc. had the capacity under Texas law to bring sue on behalf of the partnership if they were both joined. Because only one of the two partners was currently joined to the suit, its joinder was improper. The court thus granted the defendant’s motion to dismiss JBJ LLC’s claims without prejudice and granted leave to the plaintiffs to amend their complaint to join PBT Inc. as a party or to sue only in the name of the partnership.

*Moss v. Princip*, 913 F.3d 508 (5th Cir. 2019).

The court affirmed the trial court’s dismissal of a nondiverse partnership in a suit brought by two partners alleging claims against the other two partners for fraud, breach of fiduciary duty, breach of partnership agreement, conversion, and money had and received. The court concluded that the partnership was dispensable because all partners were party to the suit and the partnership’s interests in the suit were adequately represented by the partners. Further, any risk of duplicative litigation brought by the partnership itself could be prevented by injunctive relief. The court applied the same reasoning to an LLC formed by one of the plaintiffs and one of the defendants.

The plaintiffs, separately, formed partnerships with defendant Marko Princip, whereby each plaintiff received 30% ownership in the partnership. The plaintiffs filed suit against Princip and another partner, Martin,

alleging that the parties had created a partnership and that the defendants were liable for common-law fraud, breach of fiduciary duty, breach of the partnership agreement, conversion, and money had and received. The defendants removed the case to federal court from a Texas state court on the basis of diversity jurisdiction. A jury determined that a partnership existed among the parties, and the defendants moved to dismiss the claim for lack of subject-matter jurisdiction just before the entry of final judgment. The defendants argued that there was incomplete diversity due to the presence of the partnership. The plaintiffs moved to dismiss the partnership as a dispensable nondiverse party. The trial court granted the plaintiffs' motion, restoring complete diversity, and the defendants appealed.

The court of appeals first recognized that for purposes of diversity jurisdiction, a partnership is a citizen of every state in which one of its partners is a citizen. Ordinarily, diversity jurisdiction must exist at the time of removal. However, courts may dismiss nondiverse parties under Rule 21 "even after judgment has been rendered." Under Rule 19, a court can dismiss a required party who would destroy diversity if the court determines the party is dispensable. When making this determination regarding "whether, in equity and good conscience, the action should proceed among the existing parties," the court will consider four factors. These four factors are: (1) the extent to which a judgment rendered in the person's absence might prejudice that person or the existing parties; (2) the extent to which any prejudice could be lessened or avoided by protective provisions in the judgment, shaping the relief, or other measures; (3) whether a judgment rendered in the person's absence would be adequate; and (4) whether the plaintiff would have an adequate remedy if the action were dismissed for nonjoinder. As the court noted, this analysis requires a case-by-case approach.

The court noted two previous decisions of the Fifth Circuit Court of Appeals in which the court found the partnership indispensable when the claims were derivative of the partnership's interests. However, recognizing Rule 19 as a flexible and pragmatic approach, the court distinguished the two prior decisions on the basis that they involved "threatened prejudice to the partnership if the case proceeded in its absence." Further, in neither of the two cases were all constituent partners of the partnership parties to the suit. The court looked instead to decisions by sister courts in which the courts found a partnership's interest was adequately represented when all partners, or all general partners, were parties to the suit. While the court suggested the trial court could consider the tactical advantage of the partnership's presence, no such advantages were present in this case, where the partnership's role was purely passive throughout the litigation. The court acknowledged that a partnership is legally treated as a separate entity, but the court stated that "[a] partnership's interests as an entity consist of an aggregation of those interests of each of the individual partners that are relevant to the purpose of the partnership."

The court next addressed the defendants' assertion that the partnership was required to be joined as a "real party in interest" under Rule 17(a). The court pointed out that the Texas partnership statute provides for liability of a partner to a partnership or its partners for breach of the partnership agreement or violation of duties. The court commented in a footnote that some Texas courts have construed the statute to restrict partners' ability to sue for actions that have diminished the value of the partnership, but the court pointed out that these cases only address limited partnerships, and the court cited other cases indicating that the logic of these limited partnership cases is not universally accepted. The court stated that it could not conclude that the partnership was required to be joined as a plaintiff here because any interest of the partnership was fully represented and vindicated and there was no need to preserve partnership assets for all partners' benefit. The court reiterated that the partnership was a proper party but was not indispensable since its interest was fully represented by the presence of all partners. The court further explained that "the fact that an absent person could bring the action as a real party in interest does not of itself make that person a necessary or indispensable party." Although Rule 17 insures that a judgment will generally have proper effect as *res judicata* and protect a defendant from the risk of subsequent litigation, the court stated that any risk of duplicative litigation could be alleviated through properly tailored protective provisions in the judgment (such as injunctive relief prohibiting the plaintiffs from suing the defendants on behalf of the partnership on claims the partnership could have raised in the suit and ordering the plaintiffs to cause the partnership to release the claims as a condition of judgment).

The defendants also raised essentially the same challenges based on the presence of an LLC formed by one of the plaintiffs and one of the defendants. The court stated that the defendants did not argue that the LLC should be treated differently from the partnership, and the court stated that its analysis extended to the LLC, which was also dismissed by the district court.

In sum, the court concluded that the partnership and LLC were not indispensable parties, and the court remanded the case in order for the district court to consider appropriate injunctive relief to guard against any risk of duplicative litigation.

*PNC Bank, N.A. v. 2013 Travis Oak Creek GP, LLC*, 1:17-CV-584-RP, 1:17-CV-560-RP, 2018 WL 6431005 (W.D. Tex. Sep. 28, 2018).

The court held that a removed general partner of a limited partnership had standing to bring its claims for breach of fiduciary duty as direct claims because the removed general partner alleged claims that diminished the value of its interest exclusively rather than the value of the investment generally. The court held that the removed general partner had standing to sue the limited partners for breach of the partnership agreement because the removed general partner alleged a unique injury rather than an injury to the partnership. The court held that the removed general partner lacked standing to sue for breach of a permanent financing commitment and delivery assurance certificate because the removed partner signed these documents only in its representative capacity on behalf of the partnership.

PNC Bank, N.A. (“PNC”), Columbia Housing SLP Corporation (“Columbia Housing”), and 2013 Oak Creek GP, LLC (“Oak Creek GP”) agreed to form a limited partnership to develop a low-income apartment complex in Austin. PNC and Columbia Housing were the original limited partners, and Oak Creek GP was the original general partner. After construction defects were discovered in the project and problems arose in obtaining permanent financing, the limited partners removed Oak Creek GP as general partner. PNC, Columbia Housing, and the partnership sued Oak Creek GP and related parties alleging various causes of action, and the defendants counterclaimed alleging various causes of action, including breach of fiduciary duty, breach of the partnership agreement, and breach of certain other agreements related to the project. The plaintiffs argued that Oak Creek GP lacked standing to pursue its counterclaims on the basis that the claims belonged to the partnership and Oak Creek GP lacked authority to bring derivative claims on behalf of the partnership.

The court began its analysis by observing that a partnership is an entity distinct from its partners, and partners in a limited partnership have standing to pursue two types of claims: direct claims and derivative claims. A derivative action is required when an injury is in reality suffered by the limited partnership, and partners lack standing to recover personally for harms suffered by the partnership. Although partners do not have standing to sue for injuries to the partnership that merely diminish the value of the partner’s interest, “a partner who is ‘personally aggrieved’ may bring claims for those injuries he suffered directly.” With respect to derivative claims, the court stated that a general partner acting with authority in a limited partnership may sue derivatively only when a majority-in-interest of partners agree or if otherwise provided in the partnership agreement. Tex. Bus. Orgs. Code §§ 152.209, 153.152(a). Oak Creek GP had been removed as the general partner, and even if Oak Creek GP were still the general partner, the terms of the partnership agreement did not permit it to pursue claims on behalf of the partnership without Columbia Housing’s consent.

With respect to claims for breach of fiduciary duty, the court contrasted case law in which recovery was sought for a unique injury to a partner versus case law in which a partner suffered a proportionate economic injury or loss of investment that stemmed from an injury to the partnership itself, pointing out that a partner has standing to bring the former type of claim as a direct claim but not the latter. Oak Creek GP’s complaint specifically alleged that the plaintiffs owed both Oak Creek GP and the partnership fiduciary duties, and (unlike cases alleging mismanagement of partnership funds or diminished partnership interests) Oak Creek GP alleged unique losses suffered personally as follows: (1) the purported loss of Oak Creek GP’s rights to distributions of partnership cash flow, (2) the purported termination of a promissory note owed to Oak Creek GP; and (3) an affiliated developer’s deferred development fees. With respect to the first injury, the court stated that Oak Creek GP could not sue directly for “distributions, profits, and other benefits” allegedly lost because of harms suffered by the partnership, but the remaining two injuries allegedly resulting from breach of fiduciary duty were unique to one or more counterclaimants. Thus, Oak Creek GP’s claim involved matters that diminished the value of its interest exclusively, rather than the investment in the limited partnership generally, and the allegations were sufficient to establish standing to pursue a direct fiduciary-duty claim.

The court next addressed Oak Creek GP’s claims for breach of the partnership agreement. The court acknowledged that Oak Creek GP was a party to the partnership agreement and that partners may sue to enforce rights under the partnership agreement, citing Tex. Bus. Orgs. Code §§ 152.211(b)(1), 153.152(a)(1). The court recognized that the partnership agreement detailed various duties and obligations between the parties and regulated



the relationship between the partners and their roles in the partnership. Nevertheless, the court stated that Oak Creek GP still must allege a unique injury rather than an injury suffered by the partnership. Because Oak Creek GP alleged unique harm in the form of the termination of a promissory note owed to Oak Creek GP and deferred development fees owed to an affiliated developer, the court concluded that standing was established to pursue the claims for breach of the partnership agreement.

With respect to Oak Creek GP's claims against PNC for breach of a commitment for permanent financing and breach of a delivery assurance certificate, the court concluded that Oak Creek GP lacked standing. The only parties to these documents were PNC and the partnership. Oak Creek GP signed the documents only in its representative capacity for the partnership. Thus, Oak Creek GP lacked standing to pursue claims based on these agreements.

***County of El Paso v. Navar***, No. 08-17-00058-CV, 2018 WL 2715298 (Tex. App.—El Paso June 6, 2018, no pet.).

“Only the party whose primary legal right has been breached has standing. ‘Without breach of a legal right belonging to the plaintiff no cause of action can accrue to his benefit.’ *Nobles v. Marcus*, 533 S.W.2d 923, 927 (Tex. 1976) (only the defrauded party may bring suit to set aside a deed obtained by fraud). To have standing, ‘a plaintiff must demonstrate that he or she possesses an interest in a conflict distinct from that of the general public, such that the defendant’s actions have caused the plaintiff some particular injury.’ *Sneed v. Webre*, 465 S.W.3d 169, 180 (Tex. 2015) (quoting *Williams v. Lara*, 52 S.W.3d 171, 178-79 (Tex. 2001)). For example, an individual stakeholder in a legal entity does not have standing to recover personally for harms done to the legal entity. Likewise, a limited partner lacks standing to assert claims individually for injuries to the partnership that merely diminish the value of the partnership interests or reduce his share of partnership income because those claims belong to the partnership itself. The same is true for a member of a limited liability company. ‘It is the nature of the wrong, whether directed against the entity only or against the individual stakeholder, and not the existence of injury, that determines who may sue.’”

***Roan Brothers Tile Company v. City of Garland***, Civ. A. No. 3:04-CV-1090-B ECF, 2006 WL 8437017 (N.D. Tex. Jan. 12, 2006). (Although the court issued this opinion in 2006, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

“Turning first to Plaintiffs’ state law claims, in a recent opinion, the Court of Appeals for Dallas held that partners may not recover individually for injuries to the partnership. *Nauslar v. Coors Brewing Co.*, 170 S.W.3d 242, 250 (Tex. App.—Dallas 2005, no pet. h.). This holding followed the general rule that a stakeholder in a legal entity does not have a right to recover personally for harms done to the legal entity. This legal principle has been applied to bar suits by stockholders, employees, and partners seeking personal damages for injuries to the legal entity. The rationale behind this rule is that damages for the loss in value of the partnership interest are subsumed in the partnership’s causes of action. As stated by the Court of Appeals in *Nauslar*, ‘The right of recovery is [the partnership’s] right alone, even though the economic impact of the alleged wrongdoing may bring about reduced earnings, salary, or bonus.’ Such reasoning has been adopted by the Fifth Circuit with respect to cases under Texas law.

Here, there is simply no allegation that any of Billy or Don Roan’s individual property was injured or even affected by Defendants’ actions. The only individual harm claimed by Billy and Don Roan was the alleged mental anguish they suffered while watching the trailer being towed and the subsequent harm to Roan Brothers’ [a general partnership] business. Plaintiffs have presented no legal authority or argument that mental anguish alone is sufficient to support any of Plaintiffs’ state law causes of action. Therefore, the Court must dismiss Billy and Don Roan’s state law claims for lack of standing.”

## **O. Direct and Derivative Claims**

***In re Luecke***, 569 S.W.3d 313 (Tex. App.—Austin 2019, mand. denied).

The court of appeals held that the trial court abused its discretion in granting the general partner’s motion to disqualify a limited partner’s attorney. The court rejected the general partner’s argument that a limited partner, as a matter of law, cannot waive a conflict of interest on behalf of the limited partnership.

Jimmie and Dorothy Luecke, the parents of Fred and Susan, divorced in 1987 and eventually entered into a settlement agreement that led to the creation of Jimmie Luecke Children Partnership, Ltd. (“Children One”) and Jimmie Luecke Children Partnership II, Ltd. (“Children Two”). The settlement agreement obligated Jimmie to place certain assets into Children One and Children Two (collectively, the “Children Partnerships”). The Children Partnerships had a similar structure, such that Jimmie was the sole general partner, and Jimmie, Fred, and Susan were the three limited partners.

In the derivative litigation underlying this mandamus action, Fred alleged that Jimmie mishandled a tract of land (the “Tract”) prospectively belonging to Children One. The Tract was conveyed to Jimmie while he was still married to Dorothy. In 2014, the grantor’s successor, the Bennie C. Jaehne 2010 Trust (“Jaehne”), sued Jimmie in a separate lawsuit. According to the petition in that suit, Jimmie owned a mineral interest in the Tract and was a trustee for Jaehne’s reserved mineral interest in the Tract. Fred sued Jimmie in 2016, alleging that Jimmie impermissibly gave away assets that rightfully belonged to Children One by failing to disclose an interest in the Tract. Fred’s petition further stated that after he raised this mishandling issue, Jimmie deeded the Tract to Children One and conveyed revenues produced from the Tract to Children One. Each version of Fred’s petition disclosed that Fred’s attorney was the same attorney who had filed the ongoing suit on behalf of Jaehne. In 2017, Fred signed an “affidavit waiving conflict of interest” that included a reaffirmation of his attorney’s representation in actions that result from being a limited partner of Children One.

After recognizing the potential conflict of interest that Fred’s attorney might have by representing Fred and Jaehne in separate suits relating to Jimmie’s alleged mishandling of the Tract, counsel for the Children Partnerships (as nominal defendants) filed a motion to disqualify Fred’s attorney. The motion asserted that: (1) there was a “clear and actual” conflict of interest between Children One and Jaehne with regard to the Tract; (2) Fred, on behalf of Children One, had neither the right to decide which claims to pursue nor waive a conflict of interest; and (3) Fred’s attorney did not have such a waiver from an authorized representative of Children One, which he would need in order to pursue derivative claims on its behalf given this conflict. Counsel for the nominal defendants acknowledged Fred’s waiver but contended that it was ineffective because only Jimmie, as the sole general partner, could waive a conflict on behalf of Children One.

The district court granted the motion to disqualify and Fred sought mandamus relief. Mandamus is the appropriate method to correct a trial court’s erroneous order disqualifying counsel because there is no adequate remedy by appeal. The applicable standard of review applied by the court of appeals was for abuse of discretion.

The issue before the court of appeals was whether the nominal defendants, as movants, met their burden of establishing the propriety of disqualification. Fred argued that no evidence was presented to support disqualification, while the nominal defendants argued that there was a conflict of interest that had not been waived under Rule 1.06 of the Texas Disciplinary Rules of Professional Conduct (the “TDRPC”).

The court of appeals began its analysis with the observation that disqualification is a “severe remedy” because it can result in immediate and palpable harm, disrupt proceedings, and deprive a party of the right to choose counsel. The court cited case law for the proposition that because the TDRPC serve as “guidelines—not controlling standards” for disqualification motions, the movant must demonstrate more than the violation of a disciplinary rule but that the “opposing lawyer’s conduct caused actual prejudice that requires disqualification.”

Rule 1.06 is the general rule governing conflicts of interest, which prohibits contemporaneous representation in “substantially related matter[s]” of clients whose interests are “materially and directly adverse.” TDRPC 1.06(b). However, Rule 1.06(c) permits such representation if (1) the attorney reasonably believes the representation of each client will not be materially affected; and (2) each affected or potentially affected client provides informed consent after full disclosure of the common representation. TDRPC 1.06(c).

The court cited Subchapter I of Chapter 153 of the Texas Business Organizations Code (Sections 153.401 through 153.405), which authorizes and governs derivative actions brought by a limited partner on behalf of limited partnerships.

According to the record before the court of appeals: (1) the allegations of mishandling the Tract involved *only* Children One and not Children Two; (2) Children One and Jaehne were each suing Jimmie to recover proceeds from mineral rights on the Tract; and (3) the nominal defendants agreed that Fred and Jaehne each provided conflict waivers to Fred’s attorney. In support of their argument that the conflict of interest remained, the nominal defendants asserted that Fred’s waiver should be disregarded because Fred, as a matter of law, cannot waive the conflict of interest on behalf of Children One. The court rejected this argument for two reasons. First, the court observed that Fred was a limited partner and had the statutory authority to bring a suit derivatively on behalf of

Children One before concluding that the right to bring an action and choose an attorney included the right to waive a conflict of interest for purposes of the derivative action.

Second, the court noted that the record showed that the claimed conflict of interest between Children One and Jaehne was *not yet* an actual conflict. The court pointed out that the objective of Fred's suit was a determination of what Jimmie owned at the time the settlement agreement was reached, as those assets should have been considered for inclusion in the settlement agreement for the benefit of the limited partners. Because Fred's suit did not appear to seek to recover from Jimmie the mineral interest reserved by Jaehne, the court reasoned that Fred's claims against Jimmie were not necessarily inconsistent with Jaehne's claims. Therefore, the court determined that the nominal defendants had alleged possible prejudice and not actual prejudice that required disqualification.

The court of appeals concluded that instead of meeting their burden of establishing that disqualification was proper, the nominal defendants provided (1) an unsupported argument that a limited partner, unquestionably permitted by statute to bring a derivative claim on behalf of a partnership, had no right to waive a conflict of interest and (2) allegations of possible prejudice. As a result, the court held that the district court abused its discretion in granting the motion to disqualify Fred's attorney. Thus, the court of appeals conditionally granted mandamus relief and ordered the district court to vacate its order granting the motion to disqualify counsel.

***Moss v. Princip***, 913 F.3d 508 (5th Cir. 2019).

The court affirmed the trial court's dismissal of a nondiverse partnership in a suit brought by two partners alleging claims against the other two partners for fraud, breach of fiduciary duty, breach of partnership agreement, conversion, and money had and received. The court concluded that the partnership was dispensable because all partners were party to the suit and the partnership's interests in the suit were adequately represented by the partners. Further, any risk of duplicative litigation brought by the partnership itself could be prevented by injunctive relief. The court applied the same reasoning to an LLC formed by one of the plaintiffs and one of the defendants.

The plaintiffs, separately, formed partnerships with defendant Marko Princip, whereby each plaintiff received 30% ownership in the partnership. The plaintiffs filed suit against Princip and another partner, Martin, alleging that the parties had created a partnership and that the defendants were liable for common-law fraud, breach of fiduciary duty, breach of the partnership agreement, conversion, and money had and received. The defendants removed the case to federal court from a Texas state court on the basis of diversity jurisdiction. A jury determined that a partnership existed among the parties, and the defendants moved to dismiss the claim for lack of subject-matter jurisdiction just before the entry of final judgment. The defendants argued that there was incomplete diversity due to the presence of the partnership. The plaintiffs moved to dismiss the partnership as a dispensable nondiverse party. The trial court granted the plaintiffs' motion, restoring complete diversity, and the defendants appealed.

The court of appeals first recognized that for purposes of diversity jurisdiction, a partnership is a citizen of every state in which one of its partners is a citizen. Ordinarily, diversity jurisdiction must exist at the time of removal. However, courts may dismiss nondiverse parties under Rule 21 "even after judgment has been rendered." Under Rule 19, a court can dismiss a required party who would destroy diversity if the court determines the party is dispensable. When making this determination regarding "whether, in equity and good conscience, the action should proceed among the existing parties," the court will consider four factors. These four factors are: (1) the extent to which a judgment rendered in the person's absence might prejudice that person or the existing parties; (2) the extent to which any prejudice could be lessened or avoided by protective provisions in the judgment, shaping the relief, or other measures; (3) whether a judgment rendered in the person's absence would be adequate; and (4) whether the plaintiff would have an adequate remedy if the action were dismissed for nonjoinder. As the court noted, this analysis requires a case-by-case approach.

The court noted two previous decisions of the Fifth Circuit Court of Appeals in which the court found the partnership indispensable when the claims were derivative of the partnership's interests. However, recognizing Rule 19 as a flexible and pragmatic approach, the court distinguished the two prior decisions on the basis that they involved "threatened prejudice to the partnership if the case proceeded in its absence." Further, in neither of the two cases were all constituent partners of the partnership parties to the suit. The court looked instead to decisions by sister courts in which the courts found a partnership's interest was adequately represented when all partners, or all general partners, were parties to the suit. While the court suggested the trial court could consider the tactical advantage of the partnership's presence, no such advantages were present in this case, where the partnership's role was purely passive throughout the litigation. The court acknowledged that a partnership is legally treated as a

separate entity, but the court stated that “[a] partnership’s interests as an entity consist of an aggregation of those interests of each of the individual partners that are relevant to the purpose of the partnership.”

The court next addressed the defendants’ assertion that the partnership was required to be joined as a “real party in interest” under Rule 17(a). The court pointed out that the Texas partnership statute provides for liability of a partner to a partnership or its partners for breach of the partnership agreement or violation of duties. The court commented in a footnote that some Texas courts have construed the statute to restrict partners’ ability to sue for actions that have diminished the value of the partnership, but the court pointed out that these cases only address limited partnerships, and the court cited other cases indicating that the logic of these limited partnership cases is not universally accepted. The court stated that it could not conclude that the partnership was required to be joined as a plaintiff here because any interest of the partnership was fully represented and vindicated and there was no need to preserve partnership assets for all partners’ benefit. The court reiterated that the partnership was a proper party but was not indispensable since its interest was fully represented by the presence of all partners. The court further explained that “the fact that an absent person could bring the action as a real party in interest does not of itself make that person a necessary or indispensable party.” Although Rule 17 insures that a judgment will generally have proper effect as *res judicata* and protect a defendant from the risk of subsequent litigation, the court stated that any risk of duplicative litigation could be alleviated through properly tailored protective provisions in the judgment (such as injunctive relief prohibiting the plaintiffs from suing the defendants on behalf of the partnership on claims the partnership could have raised in the suit and ordering the plaintiffs to cause the partnership to release the claims as a condition of judgment).

The defendants also raised essentially the same challenges based on the presence of an LLC formed by one of the plaintiffs and one of the defendants. The court stated that the defendants did not argue that the LLC should be treated differently from the partnership, and the court stated that its analysis extended to the LLC, which was also dismissed by the district court.

In sum, the court concluded that the partnership and LLC were not indispensable parties, and the court remanded the case in order for the district court to consider appropriate injunctive relief to guard against any risk of duplicative litigation.

***PNC Bank, N.A. v. 2013 Travis Oak Creek GP, LLC***, 1:17-CV-584-RP, 1:17-CV-560-RP, 2018 WL 6431005 (W.D. Tex. Sep. 28, 2018).

The court held that a removed general partner of a limited partnership had standing to bring its claims for breach of fiduciary duty as direct claims because the removed general partner alleged claims that diminished the value of its interest exclusively rather than the value of the investment generally, but the court dismissed the claims for breach of fiduciary duty against the limited partners because the removed general partner did not allege sufficient control on the part of the limited partners to support the existence of a fiduciary duty.

PNC Bank, N.A. (“PNC”), Columbia Housing SLP Corporation (“Columbia Housing”), and 2013 Oak Creek GP, LLC (“Oak Creek GP”) agreed to form a limited partnership to develop a low-income apartment complex in Austin. PNC and Columbia Housing were the original limited partners, and Oak Creek GP was the original general partner. After construction defects were discovered in the project and problems arose in obtaining permanent financing, the limited partners removed Oak Creek GP as general partner. PNC, Columbia Housing, and the partnership sued Oak Creek GP and related parties alleging various causes of action, and the defendants counterclaimed alleging various causes of action, including breach of fiduciary duty.

The plaintiffs argued that Oak Creek GP lacked standing to pursue its counterclaim for breach of fiduciary duty on the basis that the claim belonged to the partnership and Oak Creek GP lacked authority to bring derivative claims on behalf of the partnership.

The court began its analysis by observing that a partnership is an entity distinct from its partners, and partners in a limited partnership have standing to pursue two types of claims: direct claims and derivative claims. A derivative action is required when an injury is in reality suffered by the limited partnership, and partners lack standing to recover personally for harms suffered by the partnership. Although partners do not have standing to sue for injuries to the partnership that merely diminish the value of the partner’s interest, “a partner who is ‘personally aggrieved’ may bring claims for those injuries he suffered directly.”

With respect to derivative claims, the court stated that a general partner acting with authority in a limited partnership may sue derivatively only when a majority-in-interest of partners agree or if otherwise provided in the partnership agreement. Tex. Bus. Orgs. Code §§ 152.209, 153.152(a). Oak Creek GP had been removed as the

general partner, and even if Oak Creek GP were still the general partner, the terms of the partnership agreement did not permit it to pursue claims on behalf of the partnership without Columbia Housing's consent. The plaintiffs argued that Oak Creek GP's claims were derivative claims, and thus Oak Creek GP lacked standing to assert the claims, because it sought to recover for breaches of duties owed to the partnership, not Oak Creek GP.

The court contrasted case law in which recovery was sought for a unique injury to a partner versus case law in which a partner suffered a proportionate economic injury or loss of investment that stemmed from an injury to the partnership itself, pointing out that a partner has standing to bring the former type of claim as a direct claim but not the latter. Oak Creek GP's complaint specifically alleged that the plaintiffs owed both Oak Creek GP and the partnership fiduciary duties, and (unlike cases alleging mismanagement of partnership funds or diminished partnership interests) Oak Creek GP alleged unique losses suffered personally as follows: (1) the purported loss of Oak Creek GP's rights to distributions of partnership cash flow, (2) the purported termination of a promissory note owed to Oak Creek GP; and (3) the an affiliated developer's deferred development fees. With respect to the first injury, the court stated that Oak Creek GP could not sue directly for "distributions, profits, and other benefits" allegedly lost because of harms suffered by the partnership, but the remaining two injuries allegedly resulting from breach of fiduciary duty were unique to one or more counterclaimants. Thus, Oak Creek GP's claim involved matters that diminished the value of its interest exclusively, rather than the investment in the limited partnership generally, and the allegations were sufficient to establish standing to pursue a direct fiduciary-duty claim.

The court next considered whether Oak Creek GP's breach-of-fiduciary-duty claims should be dismissed for failure to state a claim, and the court concluded that the allegations did not allege a level of control on the part of the limited partners sufficient to result in the existence of a fiduciary duty on the part of the limited partners. Thus, the court dismissed the counterclaim for breach of fiduciary duty.

*Clapper v. American Realty Investors, Inc.*, Civil Action No. 3:14-CV-2970-D, 2018 WL 1083609 (N.D. Tex. Feb. 28, 2018).

The court dismissed for lack of subject matter jurisdiction because the court concluded that a non-party limited partnership's citizenship must be considered in determining whether there was diversity of citizenship where the plaintiff was the general partner of the limited partnership and asserted causes of action that belonged to the partnership and the limited partnership was thus the real party in interest. The court recognized that the general partner had standing to sue on behalf of the partnership under Texas law and the terms of the partnership agreement, but because it was clear that the general partner sought to recover damages on behalf of the partnership, the partnership was the real party in interest whose citizenship was determinative for purposes of diversity jurisdiction. Because the partnership's citizenship included the citizenship of all its partners, and one of its partners was a defendant, the court could not exercise diversity jurisdiction.

## **P. Accounting**

*Marshall v. Ribosome L.P.*, No. 01-18-00108-CV, 2019 WL 2041062 (Tex. App.—Houston [1st Dist.] May 9, 2019, no pet. h.) (mem. op.).

The court held that a limited partner did not have a right to an accounting where the partnership agreement required certain information to be furnished to the limited partner and gave a right of access to books and records but did not provide the right to an accounting. The court pointed out that Tex. Bus. Orgs. Code § 153.105 provides that a limited partner's rights may be created only by the certificate of formation, partnership agreement, or provisions of the statute, and the court stated that the limited partner did not identify any source conferring the right to an accounting.

The court also rejected the limited partner's claim that the partnership owed him a fiduciary duty to provide an accounting based on his limited partner status. The limited partner cited no authority for the proposition, and the court stated that it was clear that fiduciary powers or liabilities belonged to the general partner rather than the partnership, citing Tex. Bus. Orgs. Code § 153.152.

*Maintenance Engineers, Inc. v. G2-V Enterprises*, EP-15-CV-00024-FM, 2015 WL 13805457 (W.D. Tex. Dec. 7, 2015). (Although the court issued this opinion in 2015, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court stated that a joint venturer has a right to maintain an action for an accounting of the joint venture against a co-venturer based on Tex. Bus. Orgs. Code § 152.211(b)(3), which provides this right to partners in a partnership, relying on *Truly v. Austin*, 744 S.W.2d 934, 937 (Tex. 1988), which explains that the same rules apply to joint venturers as partners. However, the court denied the request for an accounting because there was no showing that the underlying facts or accounts were so complicated that an equitable accounting was warranted, and such a showing is a prerequisite for an equitable accounting.

## **Q. Divorce of Partner**

*Etheridge v. Opitz*, No. 12-18-00088-CV, 2019 WL 1416853 (Tex. App.—Tyler Mar. 29, 2019, no pet. h.) (mem. op.).

In a post-divorce action for division of several tracts of property that the ex-wife claimed were purchased by the couple during marriage and were not divided in the divorce decree, the court of appeals held that certain tracts were owned by the couple and other tracts were owned by a partnership formed during the marriage (the couple’s community interest in the partnership was awarded to the ex-husband in the divorce). Thus, the ex-wife was entitled to partition of the tracts that were owned as community property, but the ex-wife had no interest in the property that was partnership property.

Jaime Etheridge brought a post-divorce action for division of six tracts of land purchased during her marriage to Eric Opitz. Jaime asserted that these tracts of land were community property that had not been divided in the divorce decree. The divorce decree awarded the couple’s residence and the community interest in a dairy business known as Summit Dairy to Eric and imposed the debt associated with both the residence and Summit Dairy on Eric. Jaime was awarded \$50,000 for “her community interest in the marital residence and in the business known as Summit Dairy.” The tracts of land at issue, title to which was held in the names of Eric and Jaime (and in the case of three of the tracts, in the names of Eric, Jaime, and Eric’s parents), were not specifically mentioned in the divorce decree.

Eric’s theory at trial, which was not pleaded by Eric, was that the property at issue was partnership property belonging to Summit Dairy, and Jaime complained that this assertion required a verified plea. The court of appeals held that Eric’s assertion that the property was owned by the partnership under partnership law was not an argument of lack of capacity or a defect in parties and thus did not require a verified plea under Tex. R. Civ. Pro. 93.

At trial, the jury found that Jaime had no interest in any of the tracts, and the trial court entered judgment that Jaime take nothing on her claims of ownership in the six tracts of land. Jaime argued on appeal that the trial court erred in submitting an instruction that included the text of Tex. Bus. Orgs. Code § 152.102 regarding the classification of partnership property. The charge also included an instruction based on the presumption under the Texas Family Code that property acquired during marriage is community property. The court of appeals concluded that the trial court did not err in submitting the instruction on partnership property.

With regard to the sufficiency of the evidence, the court of appeals concluded that there was no evidence to rebut the community presumption as to three of the six tracts of land at issue. The first three tracts were acquired in 2002 in the names of Eric, Jaime, and Eric’s parents. At this time, Eric and Jaime were married, but the partnership was not yet in existence. Eric attempted to rebut the community presumption with evidence that the properties were purchased with partnership funds, but the court pointed out that the partnership was not yet in existence at the time of the deeds and stated that “[t]he community character of the property is determined by the date of the deed, not by the date the purchase price is paid.” In the absence of evidence rebutting the community presumption, the court examined the record for any evidence of a conveyance of these tracts to the partnership. “To convey to the partnership title to property owned by one partner at the formation of the partnership, or to make such property a partnership asset, there must be a written agreement, the same as any other contract for the sale of land.” There was no evidence of such a conveyance. All vital facts in support of Jaime’s community property interest were established as a matter of law, and the trial court erred in divesting Jaime of her community interest in these tracts.

The court of appeals examined the evidence relating to the remaining three tracts of land and found there was sufficient evidence to support the implied finding that these three tracts were partnership property. These tracts

were acquired in the names of Eric and Jaime after Eric and his father formed Summit Dairy as a partnership. Although these properties were presumptively community based on their acquisition during marriage, “Eric’s testimony that an existing partnership paid for these properties, from the purchase date, is sufficient to rebut that presumption.” The court stated that this testimony “also launched the presumption that the property is partnership property” pursuant to Tex. Bus. Orgs. Code § 152.102. The court stated that the burden then fell on Jaime to rebut that presumption, and she did not do so. “Unlike the scenario involving the first three properties, when land is acquired for purposes of a existing partnership but is held in a partner’s name, the partnership’s claim to the land is not barred by the absence of a written document of conveyance. . . . Whether property used in the partnership operation is owned by the partnership is a matter of intention.” Both Jaime and Eric testified as to the payment of the down payment and monthly payments out of partnership funds, and Eric testified that neither he nor Jaime ever wrote a personal check to pay for “anything on that property.” The court stated that this evidence showed that the parties intended the property to be partnership property, and it was of no consequence that legal title was in the names of Jaime and Eric or that Jaime was not a partner. Thus, the evidence supported the jury’s finding that Jaime had no interest in these three tracts, and the appellate court affirmed the trial court’s judgment as to the ownership of these tracts.

## **R. Bankruptcy**

*R. Hassell Builders, Inc. v. Texas Floor Service, Ltd.*, 546 S.W.3d 816 (Tex. App.—Houston [1st Dist.] 2018, pet. denied).

The defendant corporation in this case was not entitled to protection by the automatic stay entered in the bankruptcy of a partnership debtor—even though the corporation was related to the partnership—because the partnership was a separate legal entity from the corporation. In the absence of any “indication in the record that the [partnership] was a party to [the defendant’s] contract with [the plaintiff], that [the defendant] is an alter ego for the [partnership], that [the defendant] was somehow entitled to indemnity from the [partnership] for judgments entered against it, or that there was any other ‘formal tie or contractual indemnification to create . . . an identity of interests’ between the [partnership] and [the defendant] with respect to [the defendant’s] contract with [the plaintiff],” there were no “unusual circumstances” justifying a stay of the plaintiff’s claim against the non-debtor defendant in this case. Similarly, even assuming the defendant was a partner of the partnership debtor, which was not supported by the evidence, a partnership is an entity distinct from its partners, and the fact that a partner’s property may be used to satisfy a judgment against the partnership in some circumstances does not transform the partner’s property into partnership property. Thus, the court rejected the argument that the stay should apply because the plaintiff sought to recover property of the bankruptcy estate held by the defendant.

## **S. Securities Laws**

*Securities and Exchange Commission v. Arcturus Corporation*, 2019 WL 2622534, \_\_\_ F.3d \_\_\_ (5th Cir. 2019).

The Fifth Circuit reversed the district court’s summary judgment in favor of the SEC in this civil enforcement action, holding that the defendants raised issues of material fact as to whether the interests in the oil and gas joint ventures at issue were securities.

Leon Parvizian and two entities formed and controlled by him offered and sold interests in six oil and gas drilling projects . Each of these joint ventures had a managing venturer that supervised and managed the day-to-day operations and earned management fees paid by the project. The two Parvizian entities were the managing venturers on all six projects. Potential investors were contacted through a nationwide cold-calling campaign. Because the interests in the drilling ventures were not registered as securities, the SEC filed a civil enforcement action, alleging violations of the Securities Act of 1933 and the Exchange Act of 1934, against Parvizian and his two entities, as well as other entities and related individuals involved in marketing the projects. The SEC argued that the interests in these drilling projects were securities, and the defendants tried to avoid federal securities laws by labeling the projects as “joint ventures” and the investors as “partners.” The district court concluded that the joint venture interests were securities and granted summary judgment in favor of the SEC. (The district court’s opinion was summarized in the materials provided for the case law update presentation at this conference in 2017.) The defendants appealed.

The court of appeals began its analysis by explaining that the Securities Act broadly defines the term “security” to include a long list of financial instruments, including “investment contracts,” the type of security at issue in this case. Congress left it to the courts to define the term “investment contract,” and the Supreme Court did so in *S.E.C. v. W.J. Howey Co.* Under the *Howey* test, an investment contract qualifies as a security if it meets three requirements: “(1) an investment of money; (2) in a common enterprise; and (3) on an expectation of profits to be derived solely from the efforts of individuals other than the investor.” The parties did not contest that the drilling interests met the first two factors of the *Howey* test; only the third factor was at issue in this case.

While the Fifth Circuit typically employs a strong presumption that an interest in a general partnership is not a security, the court acknowledged that labeling a partner as a general or limited partner does not always reflect the reality of the allocation of power. The court explained:

To guide courts in applying the third *Howey* factor to these in-between situations, this court set forth the three *Williamson* factors—the primary source of contention here. These factors flesh out situations where investors depend on a third-party manager for their investment’s success, and each factor is sufficient to satisfy the third *Howey* factor. Under the *Williamson* factors, a partner is dependent solely on the efforts of a third-party manager when:

- (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or
- (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or
- (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.

The court then proceeded to analyze each *Williamson* factor in the context of this case.

When examining the first *Williamson* factor—whether the drilling projects left the investors so little power “that the arrangement in fact distributes power as would a limited partnership”—the court examined the legal documents setting up the arrangement and how the arrangement functioned in practice, including any barriers to the investors’ use of their powers. The court identified six critical issues that were relevant with respect to this factor: (1) the managers’ formal powers as compared to the investors’ formal powers; (2) whether the investors exercised their formal powers; (3) the voting structure of the drilling projects; (4) information available to the investors; (5) communication among the investors; and (6) the number of investors. Although the managers had a significant amount of formal power, the investors had certain countervailing powers, such as the power to remove the managers upon a 60% vote. The investors also had veto powers as well as the power to demand a meeting, develop rules and procedures governing meetings and voting, amend the joint venture agreement, receive financial information and information about third-party transactions, and inspect the project’s books. In addition to having formal powers, the investors actually voted and took actions to manage the drilling projects, which distinguished this case from others where summary judgment was appropriately granted. The court disagreed with the SEC regarding the effect of the voting structure and financial participation regarding drilling projects, stating that the structure did not present investors with a Hobson’s choice as argued by the SEC, but rather must be viewed in the context of an inherently speculative investment such as drilling. The court explained the structure as allowing investors to “stand aside, incur no further costs, and allow the ‘consenting owners’ to proceed with any completion activities desired.” With respect to available information, the court stated that the record suggested that investors were provided email updates on numerous occasions. Also, the record indicated that investors actually communicated by telephone and email. Finally, the court did not view the number of investors—from 35 to 108 in each project—as stripping the investors of their power absent further factual development.

The second *Williamson* factor examined by the court was whether the drilling project investors were “so inexperienced and unknowledgeable in business affairs” that they were “incapable of intelligently exercising” their powers. An interest in a partnership is more likely to be a security if it is sold to “inexperienced and unknowledgeable members of the general public.” The SEC argued that the investors were inexperienced because the defendants engaged in an indiscriminate cold-calling campaign that did not seek out experienced investors, and there were statements from four investors that they were inexperienced in drilling investments. The court did not



find these arguments to be dispositive at the summary-judgment stage, declining to make an inference about a group of over 340 investors based on this limited evidence. Furthermore, the record showed that many investors actually did have experience in oil and gas drilling. Analysis of this factor required consideration of both investors and offerees, but the court could not determine whether offerees were experienced or not based on the limited record at the summary-judgment stage and concluded that this factual determination was better left to the fact finder.

The third *Williamson* factor examined by the court was whether the investors were so “dependent on some unique entrepreneurial or managerial ability” of the managers that the investors were not able to “replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.” The SEC argued that the managers were irreplaceable as a practical matter not because of some special skill, but because they had the sole ability to enforce drilling contracts with the subcontractors and unfettered control over the drilling projects’ assets. According to the SEC, the structure of the ventures created two problems: (1) if the investors removed the managers, the managers would still be party to the contracts with the subcontractors, making the investors reliant on them because the managers would still have the power to enforce, or not enforce, the drilling contracts; and (2) the managers controlled all of the investors’ funds. The court was not convinced by the SEC’s arguments. The first argument was unconvincing because the record was “not clear enough to say, as a matter of law, that the web of contracts between the projects, Managers, and subcontractors made the Managers irremovable.” The court stated that the SEC merely assumed that the right to enforce the contracts with drilling subcontractors rested solely with the managers, but no evidence showed that the investors would be unable to enforce a drilling contract upon removal of a manager. Additionally, while the managers made contractual promises to find subcontractors to do the drilling, the court stated that more than contractual promises are required to find that managers are irreplaceable. The SEC’s argument that the managers were irremovable because the managers controlled all the funds failed to convince the SEC because the investors never expected to recover their funds unless the wells became productive, and the investment was segmented into the phases of drilling, completion, and subsequent operations. Thus, on the third *Williamson* factor, the defendants put forth enough evidence to raise a genuine issue of material fact.

In sum, the court concluded that the defendants raised genuine issues of material fact as to each of the *Williamson* factors, and the court reversed and remanded for trial.

***Masel v. Villarreal***, 924 F.3d 734 (5th Cir. 2019).

The court of appeals held that the plaintiff adequately alleged that interests in several limited partnerships were investment contract securities, and the district court erred in dismissing some securities-fraud claims because those claims satisfied the heightened pleading requirements under federal securities law.

Intraoperative monitoring (“IOM”) is a method of monitoring a patient’s nervous system during surgery. Adrianna Villarreal owned Medical Practice Solutions, L.L.C. (“MPS”), a medical services billing company that specialized in billing for IOM services. Anthony Casarez was certified to operate IOM machinery and had worked with David Masel, a neurosurgeon with more than thirty years of experience. Casarez informed Masel that the IOM business was very profitable and proposed a meeting between Masel, Casarez, and Villarreal to discuss investment opportunities within the industry. At the meeting, Villarreal told Masel that MPS was capable of generating the highest payouts for IOM procedures because she had developed a special algorithm—or “secret sauce,” in her words—that enabled her to collect more money for each claim. Villarreal also represented that the reimbursement cycle for such claims was around six months. Casarez agreed with and confirmed the veracity of these statements for Masel. The meeting ended with a proposal: if Masel set up businesses that provided IOM procedures, Villarreal and Casarez would manage them, and through Villarreal’s signature billing practices, they could make Masel a substantial profit. In reliance on Villarreal’s pitch, Masel and his business partner (collectively, “Masel”) agreed to her proposal. Instead of writing a check to Villarreal and Casarez, however, Masel established and invested in fifteen entities, each founded for the purpose of providing IOM services, and then hired Villarreal’s companies to operate these entities in exchange for a financial interest.

The first of these entities, Neuron Shield, LLC, contracted with CGR Investments, LLC (“CGR”), a company solely owned by Villarreal, to provide management and billing services in exchange for a 35% non-voting net-profits interest in the company. Masel then formed four limited partnerships, each with “Neuron Shield” and a number in the name. Each Neuron Shield limited partnership agreement listed a corresponding Neuron Shield LLC as the general partner and CGR as a limited partner holding a 35% interest. The limited partnership agreements also provided that the general partner could not make certain decisions, such as receiving a capital contribution or winding up the partnership, without the approval of each partner holding an interest of 20% or greater. CGR’s

interest in three of these LPs was later transferred to IOS Management Services, LLC (“IOS”), of which Villarreal was a principal member.

Villarreal’s proposal did not go according to plan. The entire arrangement between the parties collected only \$11 million of the \$190 million billed for IOM services, the reimbursement cycle lasted longer than six months, and Villarreal and Casarez redirected business to other clients. Masel sued Villarreal, MPS, CGR, IOS, and Casarez in federal district court, asserting claims under the Securities Exchange Act of 1934 (the “1934 Act”), among others. As to his securities-fraud claims, Masel alleged that Villarreal made various misrepresentations and omissions, that Casarez was liable because he adopted some of Villarreal’s misrepresentations as his own, and that the entity defendants were liable because Villarreal and Casarez made them while acting as their agents. The district court dismissed each of these claims for failure to state a claim, finding that the allegations of securities fraud were either not pleaded with sufficient particularity or nonactionable. The court did not consider the threshold question, which the defendants had raised, whether Masel had adequately pleaded the existence of a security. Masel appealed.

First, the court of appeals addressed the predicate issue of whether Masel had successfully pleaded the existence of a security. Masel sought relief under § 10(b) of the 1934 Act. To successfully state a cause of action under § 10(b), a plaintiff must plead fraud in connection with the purchase or sale of a “security,” which the 1934 Act defines broadly to include an “investment contract.” Based on the United States Supreme Court’s interpretation of “investment contract” in *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946), the Fifth Circuit applies a three-factor test that requires a plaintiff to show “(1) an investment of money; (2) in a common enterprise; and (3) on an expectation of profits to be derived solely from the efforts of individuals other than the investor.” *Williamson v. Tucker*, 645 F.2d 404, 417 (5th Cir. 1981). The third *Howey* factor was the only one in dispute in this case. The court noted that typically under *Howey*’s third factor, interests in a general partnership are not securities while limited partnership interests typically are securities. Even so, the type of partnership is not determinative: a limited partnership interest may not be a security when limited partners are given such managerial control that they are no longer dependent on the skills of a promoter or third party.

The court concluded that the limited partnership interests were investment contract securities and that Masel had adequately pleaded the existence of a security. Securities-fraud cases generally involve the investment of money by a plaintiff either directly with the defendant or in an entity controlled by the defendant, i.e., a purchase of securities by a plaintiff from a defendant. Here, by contrast, the roles were reversed: Masel’s investment went into entities he set up, and Masel argued that the agreement conveying interests to defendants as limited partners in those entities was a sale of securities in relation to which the defendants made fraudulent representations. Though the defendants exercised day-to-day managerial control, it was Masel who held controlling interests. As a result, the court focused on determining whether the *defendants* exercised sufficient managerial control such that the third *Howey* factor was satisfied, and Masel’s case depended on demonstrating that the defendants were passive investors. The defendants argued that they had too much control and extensive participation in the day-to-day work of the limited partnerships for their interests to be securities. The court disagreed and reasoned that, at this stage in the litigation, not enough was known about the defendants’ formal powers under the limited partnership agreements to say whether their powers were akin to those of a general partner. Although the defendants did take on significant responsibilities within the limited partnerships, they did so pursuant to what was essentially a service agreement that was subservient to Masel’s formal powers under the limited partnership agreements. The court declined to state that the defendant limited partners’ veto powers to block certain decisions, standing alone, sufficed to negate the existence of an investment contract with respect to the limited partnership interests.

Next, the court of appeals addressed the merits of Masel’s securities-fraud claims. In Rule 10b-5, the SEC has interpreted § 10(b) to prohibit the making of “any untrue statement of a material fact or [omission of] a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading” in connection with the sale of a security. The Private Securities Litigation Reform Act (“PSLRA”) requires plaintiffs in 10b-5 actions to satisfy a pleading requirement higher than the standard under Rule 12(b)(6). For the first element—a misstatement or omission—plaintiffs must “specify each statement alleged to have been misleading [and] the reason[s] why the statement is misleading.” To plead an omission with sufficient particularity, a plaintiff must specifically plead when a given disclosure should have been made. As to scienter, a plaintiff must plead “with particularity facts giving rise to a strong inference that the defendant acted with” scienter. In 10b-5 actions, “scienter” ranges from intentional deception to severe recklessness, the latter being defined as “an extreme departure from the standards of ordinary care, [presenting] a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it.”

The court of appeals held that the district court properly dismissed Masel's claims for some of the alleged misrepresentations and omissions against Villarreal, MPS, CGR, IOS, and Casarez, but erred in dismissing certain claims against Villarreal and the entity defendants because Masel adequately stated a 10b-5 claim for those other misrepresentations. The court of appeals also addressed the scienter requirement and concluded that Masel adequately pleaded that the defendants possessed the required scienter.

In sum, the court of appeals held that: (1) the pleadings adequately alleged that the limited partnership interests in this case were securities; (2) the district court did not err in dismissing securities-fraud claims stemming from some of the alleged misrepresentations and omissions; and (3) the district court did err in dismissing securities-fraud claims based on other alleged misrepresentations.

***Securities and Exchange Commission v. Sethi***, 910 F.3d 198 (5th Cir. 2018).

The court of appeals affirmed the district court's summary judgment in favor of the SEC based on material misstatements knowingly made by the defendant in connection with the sale of joint venture interests, which the court held were investment contract securities under the federal securities laws.

Sameer Sethi sold interests in an oil and gas joint venture through his company, Sethi Petroleum, LLC. Sethi, with the help of twenty salespersons, sought out investors using purchased lead lists in a broad cold-calling campaign. If a potential investor expressed interest and Sethi determined that the investor was "accredited," then Sethi would send a private placement memorandum ("PPM") and a copy of the joint venture agreement ("JVA"). Sethi raised over \$4 million from ninety investors.

The SEC alleged that Sethi failed to register the joint venture interests as securities and materially misrepresented his relationships with large oil companies. The SEC filed claims against Sethi under Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. The district court granted the SEC's motion for summary judgment, holding that Sethi offered securities and committed securities fraud. (The district court's opinion was summarized in the materials provided for the case law update presentation at this conference in 2017.) Sethi appealed.

The court of appeals first addressed Sethi's argument that the district court erred when it held that interests in his drilling projects were securities. The court analyzed whether the interests were "investment contracts," and thus securities as defined by federal securities laws, by applying the *Howey* test. Under the *Howey* test, an investment contract must meet three requirements: "(1) an investment of money; (2) in a common enterprise; and (3) on an expectation of profits to be derived solely from the efforts of individuals other than the investor." In this case the parties disputed the third factor.

The court explained that the critical inquiry under this factor is "whether 'the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.'" While there is a "strong presumption" that an interest in a general partnership is not a security, the Fifth Circuit in *Williamson v. Tucker* articulated three factors that overcome this presumption. Each factor is sufficient to satisfy the third *Howey* factor. Under the *Williamson* factors, a partner is dependent solely on the efforts of a third-party manager when: "(1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers."

When examining the first *Williamson* factor—whether the drilling projects left the investors so little power "that the arrangement in fact distribute[d] power as would a limited partnership"—the court examined the legal documents setting up the arrangement and how the arrangement functioned in practice. In this case, the governing venture documents gave investors some theoretical power to control the drilling projects, such as the power to remove Sethi as manager and the power to call meetings and propose amendments with a 20% vote, develop rules for meetings with a 50% vote, and veto Sethi's decisions. According to the court, however, "[t]hese powers . . . were illusory in practice. Sethi blocked investors from using their powers on numerous occasions." Although Sethi was responsible for calling meetings and soliciting votes, he never did, and the investors never held a meeting or voted on any matter. The SEC provided evidence that Sethi took numerous actions without informing investors or soliciting approval as required or promised by the JVA or PPM. Further, Sethi provided the investors little to no information. Because Sethi provided no evidence to rebut the evidence provided by the SEC that the investors could

not use their legal powers, the court of appeals held that the district court correctly concluded that Sethi's drilling projects distributed power as if they were limited partnerships. The court did not address the second and third *Williamson* factors since the court concluded that the first factor was met.

Next the court addressed Sethi's claim that the district court erred in granting summary judgment on the SEC's securities fraud claims. Proof of a violation of Rule 10b-5 based on material representations or misleading omissions requires proof of three elements: "(1) material misrepresentations or materially misleading omissions, (2) in connection with the purchase or sale of securities, (3) made with scienter." Proof of a violation of Section 17(a)(2) or (a)(3) requires proof of the same elements as for Rule 10b-5 except that negligence on the part of the defendant is sufficient. The parties disputed the first and third elements. The court reviewed evidence of statements by Sethi that suggested Sethi Petroleum had relationships with some of the largest oil companies in the world—relationships that Sethi would leverage in the venture's favor—when, in reality, these relationships did not exist. The court of appeals concluded that the district court correctly found that Sethi made material misstatements and that they were made knowingly. Accordingly, the court affirmed the district court's judgment in favor of the SEC.

## T. Conspiracy

***Crane v. Samson Resources Company***, Civ. A. No. B-07-064, 2008 WL 11394366 (S.D. Tex. Nov. 26, 2008). (Although the court issued this opinion in 2008, it is included in this year's update because it did not appear in the Westlaw database until recently.)

"[T]he Court can find no basis in Texas jurisprudence to support a claim based on an alleged conspiracy between a limited partnership and a general partner. It is difficult for the Court to conceive, particularly under the facts alleged, how a general partner acting in its capacity as a partner (i.e., on behalf of the partnership) could conspire with the very entity on whose behalf it was acting. Therefore the Cranes have no basis for their civil conspiracy claim, and the claim is hereby dismissed.

The Court believes that, theoretically, it would be possible to bring a claim based on an alleged conspiracy between a limited partnership and a general partner only where the general partner was acting in its individual capacity, and not acting on behalf of the partnership (e.g., general partner, in its individual capacity, enters into an independent contract or agreement with the limited partnership). Such facts are not alleged in the Complaint, and thus the Cranes fail to assert a civil conspiracy claim for this reason as well."

## U. RICO

***Sharif v. Wellness International Network, Ltd.***, Civ. A. No. 3:05-CV-01367-B, 2007 WL 9711726 (N.D. Tex. May 9, 2007). (Although the court issued this opinion in 2007, it is included in this year's update because it did not appear in the Westlaw database until recently.)

"Section 1962(c) makes it 'unlawful for any person employed by or associated with any enterprise . . . to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity[.]' Plaintiffs assert that each of the Defendants are RICO "persons", and they assert two enterprises: (1) WIN itself [Wellness International Network, Ltd., a limited partnership]; and (2) an association-in-fact enterprise consisting of all Defendants. Under § 1962(c), the RICO 'person' and the RICO 'enterprise' must be distinct. This required distinction is based on a textual reading of § 1962(c), which speaks of 'person[s] who are employed by or associated with the enterprise.' One can only employ, be employed by, or associate with others, 'not oneself.' WIN thus cannot be a valid enterprise because WIN is also named as a RICO person.

A RICO person's membership in an association-in-fact enterprise does not violate the person/enterprise distinction. However, '[t]he fact that officers or employees of a corporation, in the course of their employment, associate to commit predicate acts does not establish an association-in-fact enterprise distinct from the corporation.' *Elliot v. Fofufas*, 867 F.2d 877, 881 (5th Cir. 1989); *Whelan v. Winchester Prod. Co.*, 319 F.3d 225, 229 (5th Cir. 2003) ("It is not enough to establish that a defendant corporation through its agents committed the predicate acts in the conduct of its own business."); *Atkinson v. Anadarko Bank & Trust Co.*, 808 F.2d 438, 441 (5th Cir. 1987) (concluding that bank, holding company, and three bank employees did not exist separately apart from the bank); *Riverwoods Chappaqua Corp. v. Marine Midland Bank, N.A.*, 30 F.3d 339, 344 (2nd Cir. 1994) ("[B]y alleging a

RICO enterprise that consists merely of a corporate defendant associated with its own employees or agents carrying on the regular affairs of the defendant, the distinctness requirement may not be circumvented.”). Although each [of] these cases involved corporations, the Court perceives of no reason why the same principle should not apply to partnerships. *See Yellow Bus Lines, Inc. v. Drivers, Chauffeurs & Helpers Local Union Local Union 639*, 883 F.2d 132, 141 (D.C. Cir. 1989), modified on other grounds, 913 F.2d 948 (D.C. Cir. 1990) (“[W]hile the corporate or organizational defendant may itself be a member of the enterprise association, the member[s] of the enterprise association may not simply be subdivisions, agents, or members of the defendant organization.”) (emphasis added). Here Plaintiffs simply allege that the association enterprise consists of WIN itself, its general partner (WINNI), WINNI’s officers (Ralph and Cathy Oats), and a WIN employee (Matthews). Because the purported members of the association enterprise are all constituent members of WIN, Plaintiffs have failed to plead the existence of an association-in-fact enterprise apart from WIN.”

## V. Power of Eminent Domain

*Graves v. Lone Star NGL Pipeline LP*, No. 09-18-00173-CV, 2019 WL 962544 (Tex. App.—Beaumont Feb. 28, 2019, no pet. h.) (mem. op.).

The court of appeals affirmed the trial court’s summary judgment in favor of a limited partnership seeking to exercise the power of eminent domain. The court held that authority to make the requisite declaration of necessity had been properly delegated to the CEO of the LLC that was the sole member of the general partner of the limited partnership.

Lone Star NGL Pipeline LP (“Lone Star”) planned to construct a natural gas pipeline that would run through Liberty County, and the route was determined after an engineering and design study. A map of the route was attached to a Consent of Member in Lieu of a Meeting (the “Consent”) signed by Kelcy Warren. Warren was the CEO of Lone Star NGL Asset Holdings II LLC (the “Company”), and the Company was the sole member of Lone Star NGL Asset GP LLC (“Lone Star GP LLC”), the sole general partner of Lone Star. The Consent outlined the relationship of the various Lone Star entities and stated that the Company, as the sole member of the general partner of Lone Star, found and determined “that public convenience, public use and necessity require that it is in the public interest” for Lone Star to acquire the land along the route. Certain landowners were unhappy with the proposed route, which traveled diagonally through their property, and Lone Star began condemnation proceedings after negotiations for an adjustment of the route failed. The landowners sought dismissal of the proceedings, arguing that Lone Star failed to establish necessity because the Consent was not executed by someone with authority to do so. The trial court denied the landowners’ plea to the jurisdiction and motion to dismiss and granted a partial summary judgment in favor of Lone Star pursuant to which the only remaining issue for determination was the amount of just compensation due to the landowners. The landowners appealed.

The landowners challenged the validity of the determination of necessity by contending that Lone Star “presented no evidence that its governing body either determined necessity or delegated authority to exercise eminent domain.” The landowners’ attack focused on Warren’s authority to sign the Consent and the relationship of the various Lone Star entities and their predecessors. The court noted that “a corporation, general partnership, limited partnership, limited liability company, or *other combination of those entities* engaged as a common carrier in the pipeline business for the purpose of transporting oil, oil products, gas . . . or other mineral solutions has all the rights and powers conferred on a common carrier by Sections 111.019-111.022, Natural Resources Code.” Tex. Bus. Orgs. Code Ann. § 2.105. (emphasis added by court). Section 111.019(b) of the Texas Natural Resources Code provides that in exercising the power of eminent domain, common carriers “may enter on and condemn the land, rights-of-way, easements, and property of any person or corporation necessary for the construction, maintenance, or operation of the common carrier pipeline.” The court stated that necessity is presumed from a determination by the condemnor unless a statute requires affirmative pleading and proof. A condemnor has the burden to show that the board of directors or other governing body or authority with power to speak made a determination of necessity, and this showing may be made through a board resolution or other evidence.

The court quoted at length from the Consent, including multiple recitals and resolutions in which the Company (in its capacity as the sole member of Lone Star GP LLC, acting general partner of Lone Star) determined the public necessity of acquiring the landowners’ property.

The landowners complained that Lone Star did not produce corporate documents relating to the authority or structure of the entities in support of the summary judgment but instead produced the affidavit of the secretary

of the Company to prove up the consent. The court noted that the Consent, along with other evidence, revealed “a combination of [Lone Star] entities” engaged in the business of constructing pipelines for the transportation of natural gas liquids as referred to in Tex. Bus. Orgs. Code Ann. § 2.105. The secretary’s affidavit outlined the history and relationship of the Lone Star entities and attached various documents, including the LLC agreements of the Company and Lone Star GP LLC. The LLC agreements addressed the management of Lone Star GP LLC and the powers of the officers of the Company and Lone Star GP LLC. The evidence submitted by Lone Star with its motion for summary judgment established that, at the time Warren executed the Consent, he was the chairman and CEO of the Company (which was formerly known by another name), which was the sole member of Lone Star GP LLC (which was formerly known by another name), which was the general partner of Lone Star (which was formerly known by another name). The landowners argued, however, that Lone Star was required to prove that the governing agreements authorized Warren, as CEO of the Company, to declare a necessity to use eminent domain “singly.”

The court pointed out provisions of the LLC agreement of the Company and actions of the sole member of the Company supporting Warren’s authority and concluded that, even assuming the LLC agreement of the Company did not expressly confer authority on Warren to “singly” sign a Consent determining public necessity, other evidence established that Lone Star and the Company ratified Warren’s declaration of necessity in the Consent. The court thus concluded that Lone Star’s general partner, acting through its sole member, duly determined the public necessity and that the Consent form coupled with the Company’s ratification of the Consent sufficiently established public necessity.

The landowners further argued that the Company was not the sole member of Lone Star GP LLC, but the court concluded that the evidence clearly established that the Company was the sole member of Lone Star GP LLC despite a mistaken reference in the LLC agreement of Lone Star GP LLC.

Finally, the landowners complained that “an officer signed the Consent, not the member, and nothing grants any agent, manager or officer the power of eminent domain.” (Presumably, although it is not entirely clear from the opinion, this reference to “the member” is a reference to the Company itself, as the sole member of the general partner, as opposed to the Company’s member, which was yet another LLC.) While the power to determine necessity for purposes of eminent domain may be validly delegated, the landowners asserted that the officers of the Company lacked express authority to authorize condemnation. The court responded that the evidence made “clear that the member is governed by the officers, who are authorized to act on behalf of the company,” and that the secretary’s affidavit specifically declared that “the general partner of Lone Star NGL Pipeline LP has throughout the Lone Star pipeline project at issue delegated responsibility to officers of the general partner and their designees, including” the engineer whose study was the basis for determining the proposed route. The court further relied on the Delaware LLC statute (the entities were organized in Delaware and agreed that Delaware law would govern their agreements), which provides that, unless otherwise provided in the LLC agreement:

a member or manager of a limited liability company has the power and authority to delegate to 1 or more other persons any or all of the member’s or manager’s, as the case may be, rights, powers and duties to manage and control the business and affairs of the limited liability company. Any such delegation may be to agents, officers and employees of a member or manager or the limited liability company[.]

6 Del. C. § 18-407. The court said that it would interpret the Company’s LLC agreement to grant all necessary powers to the officers to conduct the affairs of the company, unless specifically proscribed, citing 6 Del. C. § 18-1101(b) (“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 landowners argued that the secretary’s affidavit should be ignored because it attempted to redefine the express terms of the LLC agreements of the Company and Lone Star GP LLC. In essence, the landowners argued that orders, resolutions, and minutes were the only acceptable evidence of official company proceedings. The court rejected this argument, stating that the eminent domain statutes do not limit the type of evidence that may be presented by a condemnor in this respect.

In sum, the court concluded that Lone Star conclusively established that authority had been properly delegated to Warren, the CEO of the Company, and that the Consent executed by Warren as the CEO of the sole member of Lone Star’s general partner contained a valid declaration of necessity.

## W. Diversity Jurisdiction

Federal district courts and the Fifth Circuit Court of Appeals continue to hold that the citizenship of a partnership is determined by the citizenship of each of the partners. The cases are too numerous to include in this paper, but cases presenting somewhat unusual circumstances or arguments are included below.

*Moss v. Princip*, 913 F.3d 508 (5th Cir. 2019).

The court affirmed the trial court's dismissal of a nondiverse partnership in a suit brought by two partners alleging claims against the other two partners for fraud, breach of fiduciary duty, breach of partnership agreement, conversion, and money had and received. The court concluded that the partnership was dispensable because all partners were party to the suit and the partnership's interests in the suit were adequately represented by the partners. Further, any risk of duplicative litigation brought by the partnership itself could be prevented by injunctive relief. The court applied the same reasoning to an LLC formed by one of the plaintiffs and one of the defendants.

The plaintiffs, separately, formed partnerships with defendant Marko Princip, whereby each plaintiff received 30% ownership in the partnership. The plaintiffs filed suit against Princip and another partner, Martin, alleging that the parties had created a partnership and that the defendants were liable for common-law fraud, breach of fiduciary duty, breach of the partnership agreement, conversion, and money had and received. The defendants removed the case to federal court from a Texas state court on the basis of diversity jurisdiction. A jury determined that a partnership existed among the parties, and the defendants moved to dismiss the claim for lack of subject-matter jurisdiction just before the entry of final judgment. The defendants argued that there was incomplete diversity due to the presence of the partnership. The plaintiffs moved to dismiss the partnership as a dispensable nondiverse party. The trial court granted the plaintiffs' motion, restoring complete diversity, and the defendants appealed.

The court of appeals first recognized that for purposes of diversity jurisdiction, a partnership is a citizen of every state in which one of its partners is a citizen. Ordinarily, diversity jurisdiction must exist at the time of removal. However, courts may dismiss nondiverse parties under Rule 21 "even after judgment has been rendered." Under Rule 19, a court can dismiss a required party who would destroy diversity if the court determines the party is dispensable. When making this determination regarding "whether, in equity and good conscience, the action should proceed among the existing parties," the court will consider four factors. These four factors are: (1) the extent to which a judgment rendered in the person's absence might prejudice that person or the existing parties; (2) the extent to which any prejudice could be lessened or avoided by protective provisions in the judgment, shaping the relief, or other measures; (3) whether a judgment rendered in the person's absence would be adequate; and (4) whether the plaintiff would have an adequate remedy if the action were dismissed for nonjoinder. As the court noted, this analysis requires a case-by-case approach.

The court noted two previous decisions of the Fifth Circuit Court of Appeals in which the court found the partnership indispensable when the claims were derivative of the partnership's interests. However, recognizing Rule 19 as a flexible and pragmatic approach, the court distinguished the two prior decisions on the basis that they involved "threatened prejudice to the partnership if the case proceeded in its absence." Further, in neither of the two cases were all constituent partners of the partnership parties to the suit. The court looked instead to decisions by sister courts in which the courts found a partnership's interest was adequately represented when all partners, or all general partners, were parties to the suit. While the court suggested the trial court could consider the tactical advantage of the partnership's presence, no such advantages were present in this case, where the partnership's role was purely passive throughout the litigation. The court acknowledged that a partnership is legally treated as a separate entity, but the court stated that "[a] partnership's interests as an entity consist of an aggregation of those interests of each of the individual partners that are relevant to the purpose of the partnership."

The court next addressed the defendants' assertion that the partnership was required to be joined as a "real party in interest" under Rule 17(a). The court pointed out that the Texas partnership statute provides for liability of a partner to a partnership or its partners for breach of the partnership agreement or violation of duties. The court commented in a footnote that some Texas courts have construed the statute to restrict partners' ability to sue for actions that have diminished the value of the partnership, but the court pointed out that these cases only address limited partnerships, and the court cited other cases indicating that the logic of these limited partnership cases is not universally accepted. The court stated that it could not conclude that the partnership was required to be joined as a plaintiff here because any interest of the partnership was fully represented and vindicated and there was no

need to preserve partnership assets for all partners' benefit. The court reiterated that the partnership was a proper party but was not indispensable since its interest was fully represented by the presence of all partners. The court further explained that "the fact that an absent person could bring the action as a real party in interest does not of itself make that person a necessary or indispensable party." Although Rule 17 insures that a judgment will generally have proper effect as res judicata and protect a defendant from the risk of subsequent litigation, the court stated that any risk of duplicative litigation could be alleviated through properly tailored protective provisions in the judgment (such as injunctive relief prohibiting the plaintiffs from suing the defendants on behalf of the partnership on claims the partnership could have raised in the suit and ordering the plaintiffs to cause the partnership to release the claims as a condition of judgment).

The defendants also raised essentially the same challenges based on the presence of an LLC formed by one of the plaintiffs and one of the defendants. The court stated that the defendants did not argue that the LLC should be treated differently from the partnership, and the court stated that its analysis extended to the LLC, which was also dismissed by the district court.

In sum, the court concluded that the partnership and LLC were not indispensable parties, and the court remanded the case in order for the district court to consider appropriate injunctive relief to guard against any risk of duplicative litigation.

*Clapper v. American Realty Investors, Inc.*, Civil Action No. 3:14-CV-2970-D, 2018 WL 1083609 (N.D. Tex. Feb. 28, 2018).

The court dismissed for lack of subject matter jurisdiction because the court concluded that a non-party limited partnership's citizenship must be considered in determining whether there was diversity of citizenship where the plaintiff was the general partner of the limited partnership and asserted causes of action that belonged to the partnership and the limited partnership was thus the real party in interest. The court recognized that the general partner had standing to sue on behalf of the partnership under Texas law and the terms of the partnership agreement, but because it was clear that the general partner sought to recover damages on behalf of the partnership, the partnership was the real party in interest whose citizenship was determinative for purposes of diversity jurisdiction. Because the partnership's citizenship included the citizenship of all its partners, and one of its partners was a defendant, the court could not exercise diversity jurisdiction.

## **X. Personal Jurisdiction**

*Ball Up, LLC v. Strategic Partners Corp.*, No. 02-17-00197-CV, No. 02-17-00198-CV, 2018 WL 3673044 (Tex. App.—Fort Worth Aug. 2, 2018, no pet.) (mem. op.).

The court of appeals affirmed the trial court's orders granting the special appearances of an individual, a Delaware LLC, and a Delaware limited partnership, and reversed the trial court's denial of a Delaware corporation's special appearance.

Ball Up, LLC (Texas LLC) sued various defendants for misrepresentation and conspiracy: Mike Singer individually (CEO of Strategic Distribution, LP); Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC. These three entity defendants made general appearances. Ball Up also named as defendants Strategic Partners Corp. (Delaware corporation); PG-ACP Holdings, L.P. (Delaware limited partnership); PG-ACP Holdings GP, LLC (Delaware LLC); and Strategic Partners Acquisition Corp. (Delaware corporation) ("SPAC"). After a hearing, the trial court signed orders and amended orders sustaining special appearances filed by Singer individually and the Appellee Entities—Strategic Partners Corp.; PG-ACP Holdings, L.P.; and PG-ACP Holdings GP, LLC. The trial court denied the special appearance filed by SPAC. The court of appeals referred to the generally appearing defendants, the Appellee Entities, and SPAC collectively as the "SP Companies."

On appeal, Ball Up challenged the trial court's orders sustaining the special appearances of Singer and the Appellee Entities. SPAC similarly challenged the denial of its special appearance. Ball Up's challenge was based in part on an argument that the Texas contacts of some of the generally appearing defendants could be imputed to Singer, the Appellee Entities, and SPAC on piercing grounds. In discussing the law of personal jurisdiction based on a piercing theory, the court of appeals observed:

Concerning allegations of personal jurisdiction over a defendant based on the alter-ego theory, personal jurisdiction may exist over a nonresident defendant if the relationship between the



foreign corporation and its parent corporation that does business in Texas is one that would allow the court to impute the parent corporation's "doing business" to the subsidiary. *BMC Software Belg., N.V.*, 83 S.W.3d at 798–99. The rationale for exercising alter-ego personal jurisdiction is that "the parent corporation exerts such domination and control over its subsidiary 'that they do not in reality constitute separate and distinct corporate entities but are one and the same corporation for purposes of jurisdiction.'" *Id.* (quoting *Hargrave v. Fibreboard Corp.*, 710 F.2d 1154, 1159 (5th Cir. 1983)). The party seeking to ascribe one corporation's actions to another by disregarding their distinct corporate entities must prove this allegation because Texas law presumes that two separate corporations are indeed distinct entities. *Id.*

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 and that the degree of control the parent exercises is 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 proof required of a party seeking to fuse a parent company and a subsidiary company for jurisdictional veil-piercing purposes is different and more strenuous than the proof required of a party seeking to fuse a parent and a subsidiary company for substantive veil-piercing purposes. . . .

Because Texas law presumes that two separate corporations are distinct entities, Ball Up, as the party seeking to ascribe the actions of some of the SP Companies to other of the SP Companies for jurisdictional purposes by piercing the corporate veil, bore the burden of proving an alter-ego relationship. Absent proof by Ball Up establishing a factual basis for some legal theory, such as alter-ego or single-business enterprise, to attain corporate veil piercing that will support the aggregation of acts or contacts by separate legal entities, they will not be aggregated. That is, Ball Up's pleadings and briefing relating to acts performed by and contacts with the SP Companies (assuming the facts pleaded such contacts and acts occurred in Texas) is nonetheless not sufficient to establish general-jurisdiction minimum contacts or specific committed-a-tort-in-whole-or-in-part-in-Texas jurisdiction unless the acts and contacts Ball Up has attributed to the SP Companies are attributable to one or more of the Appellee Entities, to SPAC, or to Singer under an alter-ego/veil-piercing theory.

The court of appeals ultimately concluded that Ball Up failed to meet its burden of establishing its piercing allegations for jurisdictional purposes:

On appeal, Ball Up does not focus on the purported alter-ego relationship existing between any particular SP Companies or Singer. Instead, Ball Up argues that personal jurisdiction exists under the alter-ego/veil-piercing theory because the SP Companies "cannot prove which company(ies) made the decisions on the Ball Up project, they cannot prove which company(ies) did not make the decisions on the Ball Up Project" and that, therefore, "none of these entities can negate Ball Up's allegations that they were involved in the project." But Ball Up—not the Appellee Entities, SPAC, or Singer—had the burden of pleading and proving an alter-ego/veil-piercing theory in order to attribute contacts with the forum by one defendant to another defendant or to attribute jurisdictional acts by one defendant to another defendant.

Ball Up had the burden to overcome the presumption that two separate business entities are distinct by proving its alter-ego/veil-piercing allegation. To fuse all of the SP Companies for jurisdictional purposes—that is, to make the acts or contacts of the generally-appearing defendants Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC or of other specially-appearing defendants constitute acts or contacts by the Appellee Entities, SPAC, or Singer—Ball Up was required to establish that the Appellee Entities, SPAC, or Singer exercised a degree of control over Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC that is "greater than that normally associated with common ownership and directorship"; the evidence must show that the Appellee Entities, SPAC, Singer, and the generally-appearing defendants or some combination of these ceased to be separate.

The following factors have been identified as important to determining whether a subsidiary is separate and distinct from its parent corporation for personal jurisdiction purposes: (1) the amount of the subsidiary's stock owned by the parent corporation, (2) the existence of separate headquarters, (3) the observance of corporate formalities, and (4) the degree of the parent's control over the general policy and administration of the subsidiary. The types of evidence a court will consider as proof of alter ego—when a person is alleged to be the alter ego of a corporation but also applicable in allegations of entity-to-entity alter ego—include: (1) the payment of alleged corporate debt with personal checks or other commingling of funds; (2) representations that the individual will financially back the corporation; (3) the diversion of company profits to the individual for his personal use; (4) inadequate capitalization; and (5) other failure to keep corporate and personal assets separate.

Ball Up did not offer evidence of financial commingling of funds between any combination of the SP Companies and Singer, the payment of one of the SP Companies' debt by another or by Singer, the diversion of profits from one SP Company to another or to Singer, the failure to keep separate accounting records or corporate books, a lack of separate legal formation, or other evidence that would establish that the Appellee Entities, SPAC, or Singer exercised a degree of control over Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC that is greater than that normally associated with common ownership and directorship so that the Appellee Entities, SPAC, and the generally-appearing defendants ceased to be separate entities.

The evidence Ball Up did produce with regard to SPAC consisted of two spreadsheets containing SPAC's name that were provided to Ball Up and that detailed the Ball Up Apparel Project's expenses. Ball Up argues that these spreadsheets coupled with the alleged failure of the SP Companies to maintain separate and distinct corporate identities is sufficient to support the trial court's denial of SPAC's special appearance. We cannot agree. Even if SPAC created the spreadsheet for the project's current expenses, the two spreadsheets simply represent a calculation of expenses and do not establish any amounts billed by SPAC or work performed by SPAC. Thus, the spreadsheets are insufficient to support a showing that SPAC has the minimum contacts necessary to demonstrate that the trial court has personal jurisdiction over SPAC.

The evidence Ball Up did produce with regard to the Appellee Entities consisted of excerpts from [Robert] Pierpoint's deposition [an officer of various SP Companies] establishing that the composition of the board of directors of each of the SP Companies was the same or substantially the same; that Padraic McConville worked for Partners Group; that Partners Group was a private equity partner that sat on the board of directors for PG-ACP Holdings, GP; and that McConville put Ball Up proposal numbers together for the PG-ACP Holdings, GP's board of directors. Ball Up's evidence and contentions, however, do not rise to the required level of control and domination by one or more of the SP Companies over one or more of the other SP Companies necessary to meet Ball Up's burden of proving that the SP Companies ceased to be separate entities and are one and the same for jurisdictional purposes. [Ball Up does not specifically identify which of the generally-appearing defendants, the Appellee Entities, or SPAC are purportedly fused for jurisdictional purposes; Ball Up alleges all of them were intertwined and acted jointly.]

Ball Up's alter-ego/veil-piercing jurisdictional evidence at most shows some common ownership between the SP Companies and some common and overlapping boards of directors; this type of evidence does not establish alter ego for jurisdictional purposes. [If Ball Up had met its burden of proving alter ego, no evidence exists that piercing the corporate veil of any particular entity or entities for purposes of personal jurisdiction is necessary to prevent fraud or injustice.]

Because Ball Up failed to assert or to offer proof of acts by the Appellee Entities, SPAC, and Singer in furtherance of Ball Up's tort claims against them and also failed to meet its burden of proving its alter-ego/veil-piercing jurisdictional theory concerning the Appellee Entities, SPAC, and Singer, the trial court properly sustained the Appellee Entities' and Singer's special appearances and erred by denying SPAC's special appearance.

The court also observed: "In addition to factually negating personal jurisdiction, Singer's affidavit and special-appearance evidence legally negated personal jurisdiction; Singer established that at all times in any

dealings with Ball Up he was acting in his corporate capacity on behalf of generally-appearing Strategic Distribution. Thus, even if Singer had contacts with Texas or performed acts in Texas—which he directly denied in his affidavit—personal jurisdiction over him could not be predicated on jurisdiction over Strategic Distribution unless Strategic Distribution is the alter ego of Singer.”

## Y. Statute of Limitations

*Chapman v. Arfeen*, No. 09-16-00272-CV, 2018 WL 4139001 (Tex. App.—Beaumont Aug. 30, 2018, pet. denied) (mem. op.).

Joe Chapman appealed a summary judgment order that rejected his request for a declaratory judgment about his ownership interests in limited partnerships and dismissed his claims against defendants for breach of fiduciary duty and other actions. Defendants also appealed a summary judgment order that dismissed their claims against Chapman for breach of fiduciary duty. The court of appeals affirmed in part and reversed in part.

Chapman owned limited partner interests in various Harbor Hospice limited partnerships. He alleged that after he resigned from his employment, he was told that he was no longer a limited partner and that his limited partner interests had been converted into profit interests. To support their position that Chapman’s ownership interests were voluntarily converted into “profit interests paid out as bonuses,” defendants relied upon documentary evidence in the form of assignments and redemption agreements, as well as Chapman’s ratification of such agreements by accepting, without objection, periodic “bonus profit payments.” The court of appeals found that the trial court erred in granting summary judgment against Chapman on this claim, as there were genuine issues of material fact and problems with an affidavit relied upon by the defendants.

The defendants also claimed that the statute of limitations barred Chapman’s claims because he was aware of the transfers or assignments of his ownership interests for more than four years before he sued. The court noted that Chapman’s request for declaratory judgment and his claims for breach of the partnership agreement and breach of fiduciary duty were governed by a four-year limitations period. The court observed that, even though Chapman indicated that he did not review his K-1s when he received them, he was deemed to have constructive notice of the changes they reflected to his ownership interests. This was because “[w]hen an individual signs a Form 1040 when filing their income tax with the IRS, they are signing ‘[u]nder penalties of perjury’ that the signor has ‘examined this return and accompanying schedules and statements, and to the best of [their] knowledge and belief, they are true, correct[.]’” Nevertheless, after a lengthy discussion, the court concluded that defendants failed to conclusively establish that the statute of limitations barred Chapman’s four-year claims (although limitations did bar Chapman’s two-year claims for conversion and theft). The court also concluded that genuine issues of material fact existed on the assertion that Chapman had ratified the transfer of his ownership interests into profit interests.

*Strnad v. Behrend*, Civil Action No. SA-07-CV-680-XR, Civil Action No. SA-07-CV-741-XR, 2008 WL 11333897 (W.D. Tex. July 21, 2008). (Although the court issued this opinion in 2008, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court held that the plaintiff’s claims that a partnership existed between the plaintiff and the defendants and for enforcement of rights in connection with the partnership were barred by the statute of limitations where the plaintiff ceased to be involved in the partnership in 1997, knew of his claims at that time, and did not bring the action until 2007.

The plaintiff asserted that he and the defendants were partners in a bail bond business, and the plaintiff asserted a RICO claim and various other claims against the defendants in connection with wrongful acts committed by the defendants relating to the partnership’s business and property. The defendants denied that a partnership existed and argued that, even if a partnership existed, the plaintiff’s claims were barred by the statute of limitations because the partnership dissolved in 1997. Strnad argued that the partnership continued to the present day because there had been no winding up, relying on Tex. Rev. Civ. Stat. art. 6132b-8.02. It was undisputed that Strnad never spoke to his alleged partners or performed any act related to the partnership after November 7, 1997, and the court stated that Strnad essentially withdrew from the partnership and ceased to be a partner at that time. The court then held that Strnad’s claims were barred by limitations based on the following reasoning:

Even taking in account that Strnad may have had good cause for his departure from the alleged partnership (being shot at by his alleged partner), there is no adequate explanation offered

for Strnad's delay in exercising any of his partnership rights. Strnad waited until August 16, 2007 to file this suit. Apparently, he conscientiously decided not to pursue any claims because he and his lawyer thought the Defendants were insolvent and that the IRS got everything. Alternatively, Strnad also states in an affidavit that he didn't realize he was in a partnership because he erroneously thought that a formal written agreement was necessary. In other portions of the summary judgment evidence tendered in these cases, Strnad appears to have known that Behrend was calling him a partner before 1997. These grounds do not constitute the basis for any equitable tolling.

Although the court acknowledged that the actions of Strnad's alleged partners were quite confusing, the fact remained that if a partnership existed the "arrangement ended in 1997 and Strnad failed to timely exercise any rights he may have possessed." Thus, the RICO claims were barred by limitations and "Strnad's implied partnership claim and request for a constructive trust" were barred by the limitations period set forth in Tex. Civ. Prac. & Rem. Code § 16.004(c) ("A person must bring suit against his partner for a settlement of partnership accounts . . . not later than four years after the day that the cause of action accrues. For purposes of this subsection, the cause of action accrues on the day that the dealings in which the parties were interested together cease."). Because any claims to partnership rights were barred by limitations, the court denied several other types of relief that Strnad argued were necessary to wind up the partnership and dispose of its property.

## **Z. Service of Process**

*WWLC Investment, L.P. v. Miraki*, No. 05-17-01126-CV, 2018 WL 6818650 (Tex. App.—Dallas Dec. 28, 2018, no pet. h.) (mem. op.).

A limited partnership challenged a default judgment entered against it on the basis that substituted service on the "owner" was defective because there was no attempted service on the registered agent or a partner before the substituted service. The court held that there was no abuse of discretion in the trial court's conclusion that failing to serve the registered agent and identifying the individual served as "owner" did not result in defective service. The court of appeals pointed out that the registered agent for the limited partnership was a corporation whose charter had been involuntarily forfeited, resulting in dissolution of the corporation, prior to the substituted service. Further, the court stated that the individual who was served was president (according to a lease amendment signed by the individual on behalf of the partnership) and owner of the limited partnership at the time substituted service was effected. The court noted that each general partner of a limited partnership is an agent of the partnership for purposes of service of process under Tex. Bus. Orgs. Code § 5.225, and the court concluded that the trial court did not abuse its discretion under these circumstances in denying the partnership's bill of review.

*Jeanes v. Dallas County*, No. 05-17-01269-CV, 2018 WL 5725326 (Tex. App.—Dallas Oct. 31, 2018, no pet. h.) (mem. op.).

The court affirmed the trial court's entry of a default judgment against a general partnership erroneously named in the citation as a limited partnership, but with a general partner who was properly served.

The plaintiff named "Sierra Investment Associates, a Texas General Partnership" as the defendant in the suit and pleaded that Sierra could be served with notice by serving its general partner, Charles Wesley Jeanes. The original citation, however, was directed to "Sierra Investment Associates, a Texas Limited Partnership." Like the petition, however, the citation stated that Sierra could be served "by serving its Partner, Charles Wesley Jeanes." The officer's return for the citation showed service on "Sierra Investment Associates by delivering to its Partner, Charles Wesley Jeanes."

Jeanes and Sierra complained that the citation was defective because it described Sierra as a limited partnership instead of a general partnership. Specifically, they argued the citation for Sierra was defective because (1) it did not "show names of parties" as required by rule 99(b)(7), Texas Rules of Civil Procedure, and (2) it was not "directed to the defendant" as required by rule 99(b)(8). They contended that the error identifying Sierra as a limited partnership instead of a general partnership "rendered Plaintiffs' service upon Sierra fatally defective." Jeanes and Sierra argued that strict compliance with the rules was required and that there was no presumption of valid service.

Citing *Fidelity & Guaranty Insurance Co. v. Drewery Construction Co.*, 186 S.W.3d 571 (Tex. 2006), the court noted that default judgments should generally be set aside if the defendant did not receive the suit papers. If the papers were received, however, the judgment should be set aside only if the defendant establishes that (1) default was neither intentional nor a result of conscious indifference, (2) a meritorious defense exists, and (3) a new trial would cause neither delay nor undue prejudice (the “*Craddock* elements”). The court observed that Sierra did not argue that it failed to receive the suit papers that were served on Jeanes. The citation recited the correct name of the entity and was erroneous only because it described Sierra as a limited partnership rather than a general partnership. According to the court, nothing suggested that an entity other than the one listed in the petition was served; consequently, Jeanes and Sierra were required to prove the three *Craddock* elements to obtain reversal of the default judgment. The court concluded that “neither Jeanes nor Sierra offered any evidence to establish the . . . elements,” and the default judgment was affirmed.

Jeanes and Sierra also argued that without a valid judgment against Sierra, a judgment that had been entered against Jeanes was also invalid. *See* Tex. Bus. Orgs. Code § 152.306(a) (“A judgment against a partnership is not by itself a judgment against a partner. A judgment may be entered against a partner who has been served with process in a suit against the partnership.”). The only challenge to the judgment against Sierra, however, was the failure to serve Sierra with process—an issue that had been decided against Sierra. As a result, the court rejected the argument and allowed the judgment against Jeanes to stand.

#### **AA. Pro Se Representation**

*AG Acceptance Corp. v. Veigel*, No. 2:06-CV-272-J, 2008 WL 11452389 (N.D. Tex. Feb 11, 2008). (Although the court issued this opinion in 2008, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court reiterated, as held in a previous order in the same cause, that neither of the individual defendants could represent the corporate and partnership defendants because neither individual was a licensed attorney, and corporations and partnerships, as fictional legal persons, cannot personally appear in court.

*Wilder v. MWS Capital, LLC*, 1:18-cv-264-RP-AWA, 2018 WL 3603082 (W.D. Tex. June 12, 2018), report and recommendation adopted, 2018 WL 6795852 (W.D. Tex. Nov. 1, 2018) (stating that “a pro se plaintiff is only entitled to ‘appear on behalf of one’s self; one cannot represent another separate legal entity, such as another person, a corporation, or a partnership, pro se”).

#### **BB. Venue**

*Westberry v. GusTech Communications, LLC*, Civ. A. No. 3:17-CV-3162-D, 2018 WL 3548869 (N.D. Tex. July 24, 2018) (“Under 28 U.S.C. § 1391(c)(2), a corporate defendant is deemed to ‘reside,’ for venue purposes, in any judicial district in which it is subject to the court’s personal jurisdiction with respect to the civil action in question. ‘[A]lthough the wording of section 1391(c) only appears to apply to corporations, courts have held and it is generally accepted that unincorporated business associations such as partnerships and limited liability companies are analogous to corporations for venue purposes.’”).

*In re PlainsCapital Bank*, No. 13-17-00021-CV, 2018 WL 2979836 (Tex. App.—Corpus Christi-Edinburg June 8, 2018, no pet.) (mem. op.).

“Under the general venue statute, venue would be proper in Bexar County as the county of Cantera’s [a Texas limited partnership] principal office. *See, e.g.*, TEX. CIV. PRAC. & REM. CODE ANN. § 15.002(a). We conclude that Bexar County was a proper venue for PCB’s lawsuit insofar as it was the county of Cantera’s principal office.”

*Trilogy Cellars, LLC v. Flora Springs Wine Company*, Civ. A. No. 5:17-CV-029-C, 2017 WL 6816495 (N.D. Tex. July 11, 2017) (Although the court issued this opinion in 2017, it is included in this year’s update because it did not appear in the Westlaw database until recently.) (“For purposes of venue, a defendant that is an

unincorporated association, such as a limited liability company, is deemed to reside in any judicial district in which it is subject to personal jurisdiction at the time the action is commenced. 28 U.S.C. § 1391(c).”)

*Henry v. Bush Lewis, PLLC*, Civ. A. H-09-1152, 2009 WL 10693534 (S.D. Tex. July 31, 2009) (Although the court issued this opinion in 2009, it is included in this year’s update because it did not appear in the Westlaw database until recently.) (“Though Bush Lewis PLLC is not a corporation, courts have applied § 1391(c)’s venue provisions for corporations by analogy to unincorporated associations such as LLCs. Thus, for venue purposes, unincorporated associations like Bush Lewis PLLC reside in all districts in which they do business and thereby are subject to personal jurisdiction.”).

## **CC. Attorney Disqualification**

*In re Luecke*, 569 S.W.3d 313 (Tex. App.—Austin 2019, no pet.).

The court of appeals held that the trial court abused its discretion in granting the general partner’s motion to disqualify a limited partner’s attorney. The court rejected the general partner’s argument that a limited partner, as a matter of law, cannot waive a conflict of interest on behalf of the limited partnership.

Jimmie and Dorothy Luecke, the parents of Fred and Susan, divorced in 1987 and eventually entered into a settlement agreement that led to the creation of Jimmie Luecke Children Partnership, Ltd. (“Children One”) and Jimmie Luecke Children Partnership II, Ltd. (“Children Two”). The settlement agreement obligated Jimmie to place certain assets into Children One and Children Two (collectively, the “Children Partnerships”). The Children Partnerships had a similar structure, such that Jimmie was the sole general partner, and Jimmie, Fred, and Susan were the three limited partners.

In the derivative litigation underlying this mandamus action, Fred alleged that Jimmie mishandled a tract of land (the “Tract”) prospectively belonging to Children One. The Tract was conveyed to Jimmie while he was still married to Dorothy. In 2014, the grantor’s successor, the Bennie C. Jaehne 2010 Trust (“Jaehne”), sued Jimmie in a separate lawsuit. According to the petition in that suit, Jimmie owned a mineral interest in the Tract and was a trustee for Jaehne’s reserved mineral interest in the Tract. Fred sued Jimmie in 2016, alleging that Jimmie impermissibly gave away assets that rightfully belonged to Children One by failing to disclose an interest in the Tract. Fred’s petition further stated that after he raised this mishandling issue, Jimmie deeded the Tract to Children One and conveyed revenues produced from the Tract to Children One. Each version of Fred’s petition disclosed that Fred’s attorney was the same attorney who had filed the ongoing suit on behalf of Jaehne. In 2017, Fred signed an “affidavit waiving conflict of interest” that included a reaffirmation of his attorney’s representation in actions that result from being a limited partner of Children One.

After recognizing the potential conflict of interest that Fred’s attorney might have by representing Fred and Jaehne in separate suits relating to Jimmie’s alleged mishandling of the Tract, counsel for the Children Partnerships (as nominal defendants) filed a motion to disqualify Fred’s attorney. The motion asserted that: (1) there was a “clear and actual” conflict of interest between Children One and Jaehne with regard to the Tract; (2) Fred, on behalf of Children One, had neither the right to decide which claims to pursue nor waive a conflict of interest; and (3) Fred’s attorney did not have such a waiver from an authorized representative of Children One, which he would need in order to pursue derivative claims on its behalf given this conflict. Counsel for the nominal defendants acknowledged Fred’s waiver but contended that it was ineffective because only Jimmie, as the sole general partner, could waive a conflict on behalf of Children One.

The district court granted the motion to disqualify and Fred sought mandamus relief. Mandamus is the appropriate method to correct a trial court’s erroneous order disqualifying counsel because there is no adequate remedy by appeal. The applicable standard of review applied by the court of appeals was for abuse of discretion.

The issue before the court of appeals was whether the nominal defendants, as movants, met their burden of establishing the propriety of disqualification. Fred argued that no evidence was presented to support disqualification, while the nominal defendants argued that there was a conflict of interest that had not been waived under Rule 1.06 of the Texas Disciplinary Rules of Professional Conduct (the “TDRPC”).

The court of appeals began its analysis with the observation that disqualification is a “severe remedy” because it can result in immediate and palpable harm, disrupt proceedings, and deprive a party of the right to choose counsel. The court cited case law for the proposition that because the TDRPC serve as “guidelines—not controlling

standards” for disqualification motions, the movant must demonstrate more than the violation of a disciplinary rule but that the “opposing lawyer’s conduct caused actual prejudice that requires disqualification.”

Rule 1.06 is the general rule governing conflicts of interest, which prohibits contemporaneous representation in “substantially related matter[s]” of clients whose interests are “materially and directly adverse.” TDRPC 1.06(b). However, Rule 1.06(c) permits such representation if (1) the attorney reasonably believes the representation of each client will not be materially affected; and (2) each affected or potentially affected client provides informed consent after full disclosure of the common representation. TDRPC 1.06(c).

The court cited Subchapter I of Chapter 153 of the Texas Business Organizations Code (Sections 153.401 through 153.405), which authorizes and governs derivative actions brought by a limited partner on behalf of limited partnerships.

According to the record before the court of appeals: (1) the allegations of mishandling the Tract involved *only* Children One and not Children Two; (2) Children One and Jaehne were each suing Jimmie to recover proceeds from mineral rights on the Tract; and (3) the nominal defendants agreed that Fred and Jaehne each provided conflict waivers to Fred’s attorney. In support of their argument that the conflict of interest remained, the nominal defendants asserted that Fred’s waiver should be disregarded because Fred, as a matter of law, cannot waive the conflict of interest on behalf of Children One. The court rejected this argument for two reasons. First, the court observed that Fred was a limited partner and had the statutory authority to bring a suit derivatively on behalf of Children One before concluding that the right to bring an action and choose an attorney included the right to waive a conflict of interest for purposes of the derivative action.

Second, the court noted that the record showed that the claimed conflict of interest between Children One and Jaehne was *not yet* an actual conflict. The court pointed out that the objective of Fred’s suit was a determination of what Jimmie owned at the time the settlement agreement was reached, as those assets should have been considered for inclusion in the settlement agreement for the benefit of the limited partners. Because Fred’s suit did not appear to seek to recover from Jimmie the mineral interest reserved by Jaehne, the court reasoned that Fred’s claims against Jimmie were not necessarily inconsistent with Jaehne’s claims. Therefore, the court determined that the nominal defendants had alleged possible prejudice and not actual prejudice that required disqualification.

The court of appeals concluded that instead of meeting their burden of establishing that disqualification was proper, the nominal defendants provided (1) an unsupported argument that a limited partner, unquestionably permitted by statute to bring a derivative claim on behalf of a partnership, had no right to waive a conflict of interest and (2) allegations of possible prejudice. As a result, the court held that the district court abused its discretion in granting the motion to disqualify Fred’s attorney. Thus, the court of appeals conditionally granted mandamus relief and ordered the district court to vacate its order granting the motion to disqualify counsel.

#### **DD. Governing Law**

*Marshall v. Ribosome L.P.*, No. 01-18-00108-CV, 2019 WL 2041062 (Tex. App.—Houston [1st Dist.] May 9, 2019, no pet. h.) (mem. op.).

The court noted in a footnote that the limited partnership involved in this case claimed that it was governed by British Virgin Islands law because it was formed under those laws, but the court assumed that application of Texas law would result in the same outcome because the parties did not argue otherwise, and a choice-of-law analysis was thus not necessary.

*ASR 2620-2630 Fountainview, LP v. ASR 2620-2630 Fountainview GP, LLC*, 2019 WL 470240, \_\_\_ S.W.3d \_\_\_ (Tex. App.—Houston [14th Dist.] 2019, no pet.).

The court of appeals agreed with the trial court that a limited partner’s claim for breach of the partnership agreement was governed by Delaware law—and accordingly applied Delaware law to the interpretation of the partnership agreement and analysis of the claim—where the partners formed the partnership under the Delaware Revised Limited Partnership Act and the partnership agreement provided that the “Agreement and the rights of the parties hereunder shall be governed by, [and] interpreted and enforced in accordance with, the internal laws (exclusive of the choice of law provisions thereof) of the State of Delaware as to all matters, including, but not limited to, matters of validity, construction, effect, performance[,] and remedies.”

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

#### A. Nature of Limited Liability Company

*In re Blevins*, Case No. 17-60019-rlj7, 2019 WL 575664 (Bankr. N.D. Tex. Feb. 12, 2019).

The court discussed concerns raised by the bankruptcy trustee regarding the structure and operations of an LLC in light of bankruptcy rules regarding fee sharing among persons entitled to compensation under the Bankruptcy Code. The court referred to “confusion” and “lack of transparency caused by counsel’s misstatements in identifying who was actually debtors’ counsel” and explained that the issues stemmed from the business model of Law Solutions Chicago LLC, which attempts to provide centralized consumer bankruptcy representation on a nationwide scale. The court pointed to questions about whether the LLC is actually a law firm and whether its “partners” are, at least in part, “regular associates.” The court did not reach any conclusions on these issues because the court ordered disgorgement of all fees to the debtors to resolve mistakes made by counsel in the case.

*In re Natural Gas Consulting & Measurement, LLC*, No. 07-18-00309-CV, 2018 WL 7458616 (Tex. App.—Amarillo Oct. 10, 2018, orig. proceeding) (mem. op.).

The court of appeals held that the trial court could compel production of books and records by an LLC via deposition of the LLC’s designated representative and sanction the representative for invoking the Fifth Amendment as a shield against disclosure of the books and records. The trial court could not, however, prohibit the representative from invoking the Fifth Amendment privilege to the extent oral testimony was sought from the representative that might incriminate the representative.

The plaintiff in the underlying lawsuit sought to depose an LLC and an individual representative, and they invoked the right to refrain from incriminating themselves. The trial court then ordered that the LLC designate a “corporate representative” and indicated that the corporate representative would not be allowed to invoke the right against self-incrimination when being deposed as corporate representative and would be subject to sanctions if he did so. The LLC argued that “[t]here was no absolute rule” preventing “the sole member and only knowledgeable representative of a limited liability company from invoking the Fifth Amendment right against self-compelled incrimination” and that the LLC and its representative should not be forced to choose between asserting their constitutional rights or being subject to sanctions. The court of appeals in this mandamus proceeding relied on case law in the corporate context and *In re Russo* (see summary below) in analyzing and resolving the issues as follows:

A corporation and its human representatives are two distinct entities. Moreover, a corporation, like other “artificial entities” has no right under the Fifth Amendment of the United States Constitution to avoid incriminating itself. *Braswell v. United States*, 487 U.S. 99, 102-103, 108 S.Ct. 2284, 101 L.Ed.2d 98 (1988); *In re Russo*, 550 S.W.3d 782, 788 (Tex. App.—Houston [14th Dist.] 2018, orig. proceeding). This verity has been used to require corporate representatives who are the custodian of corporate records to produce those records even though doing so may tend to incriminate the representative. *In re Russo*, 550 S.W.3d at 788. Yet, it is just as true that the same representative cannot be made to incriminate himself via “his own *oral* testimony.” *Braswell v. United States*, 487 U.S. at 114, 108 S.Ct. 2284 (quoting *Curcio v. United States*, 354 U.S. 118, 77 S.Ct. 1145, 1 L.Ed.2d 1225 (1957) (emphasis added)). And, in Texas, no one can deny that a person acting on behalf of a corporation may be held criminally responsible for the conduct taken on behalf of the corporation. See TEX. PENAL CODE ANN. § 7.23(a) (West 2011) (stating that “[a]n individual is criminally responsible for conduct that he performs in the name of or in behalf of a corporation or association to the same extent as if the conduct were performed in his own name or behalf.”); *Ex parte Canady*, 140 S.W.3d 845, 850 (Tex. App.—Houston [14th Dist.] 2004, no pet.) (stating the same). From these, we derive the answer to the question at hand. The trial court may compel a corporate representative to appear for deposition and testify on behalf of the corporation. So too may it order the custodian of corporate books and records to produce same despite the chance that doing so incriminates both the custodian and the corporation. But, the trial court may not compel the representative designated to testify on behalf of the “artificial entity” to provide oral testimony that would incriminate himself.



Thus, the court concluded that the trial court could compel disclosure of books and records sought via a deposition of the LLC's designated corporate representative and sanction the representative for invoking the Fifth Amendment as a shield against disclosure of the books and records, but the trial court could not prohibit the representative from invoking the Fifth Amendment privilege to the extent oral testimony was sought from the representative that might incriminate the representative. To the extent the trial court's order was a blanket prohibition on assertion of the Fifth Amendment privilege at the risk of sanctions, the order was an abuse of discretion.

*In re Russo*, 550 S.W.3d 782 (Tex. App.—Houston [14th Dist.] 2018,orig. proceeding).

The court of appeals held that an individual member of an LLC could not rely on the Fifth Amendment privilege against self-incrimination to avoid producing documents sought in a discovery request in the underlying proceeding, even if the act of production incriminated the individual, because there was evidence that the documents were records of the LLC, and an artificial entity has no right against self-incrimination.

The plaintiff in the underlying proceeding served requests for production of documents on the controlling member of numerous LLCs, Christopher Russo, and Russo attempted to invoke the act-of-production privilege against self-incrimination under the Fifth Amendment. The trial court ordered Russo to produce the documents, and Russo sought to compel the trial court to vacate the order in this mandamus proceeding. The court of appeals denied the writ of mandamus because artificial entities are not protected by the Fifth Amendment, and an individual is not permitted to invoke the Fifth Amendment privilege to avoid producing records of an entity even if the records might incriminate the individual personally. Russo argued that the documents at issue, which consisted mostly of email communications, were not records of any of his LLCs, but rather were personal records. The court concluded that the evidence indicated that the emails were likely records of an LLC because they were sent or received by Russo as an agent of an LLC in the course of its business. Further, there was evidence that the Yahoo email account was used by Russo to conduct business of his LLCs. To invoke the privilege and avoid production, Russo had the burden to prove that the withheld documents were personal and not records of his entities, and Russo failed to meet that burden.

## **B. Preformation Transactions**

*Manufacturers Alliance Insurance Company v. B&B Transportation, LLC*, 1:18-CV-13-RP, 2018 WL 7288577 (W.D. Tex. Dec. 14, 2018).

The court denied an LLC's motion to dismiss an insurer's claim against the LLC for rescission of a policy based on alleged misrepresentations that were made when the policy was issued before the LLC's formation. The LLC argued that it could not be held liable for actions taken before its existence, but the court held that the insurer sufficiently pleaded ratification on the part of the LLC.

The plaintiff ("MAICO") issued a commercial business auto liability policy to "B&B Enterprise" on April 8, 2016. The name of the insured was subsequently changed to "B&B Transportation, LLC," and the policy was renewed a year later. After B&B Transportation, LLC ("B&B LLC") was sued in state court for damages arising from a fatal accident involving a bus allegedly owned by it, MAICO brought this suit against B&B LLC for rescission of the policies on the basis that B&B LLC made material misrepresentations on its applications for the policies. It was undisputed that B&B LLC did not exist in its current form at the time MAICO issued the original policy (the LLC not having been formed until April 28, 2016), and MAICO argued that the policies should be rescinded based on material misrepresentations by B&B LLC, including the fact of its existence, in obtaining the policies. B&B LLC argued that the policies should not be rescinded because B&B LLC could not have made any misrepresentations in applying for the original policy since it did not exist at that time. Taking MAICO's allegations as true in the context of B&B LLC's motion to dismiss for failure to state a claim, the court concluded that MAICO sufficiently alleged that B&B LLC ratified the policies by "acting under," performing under," or "affirmatively acknowledging" the contracts. MAICO pleaded that B&B LLC added and removed buses under the original policy, including on the day after the LLC came into existence. MAICO further alleged that the bus that was eventually involved in the fatal accident was added on that day and that B&B LLC paid the premiums on the original and renewal policies and applied for the renewal policy. The court said that, taking these facts as true, these actions constituted ratification by the LLC "by acting under the contract, performing under the contract, or affirmatively

acknowledging the contract.” Thus, MAICO sufficiently pleaded that B&B LLC could be held liable for actions taken before the date it was formed as an LLC in connection with obtaining the policies.

*Tyson and Billy Architects, PC v. Kingdom Perspectives G.P., Ltd.*, Civil Action No. 6:19-CV-00053-JDK, 2019 WL 2127343 (E.D. Tex. Apr. 24, 2019).

The court held that the plaintiff stated a claim against the defendant for breach of contract and judicial foreclosure of a mechanic’s and materialman’s lien based on the plaintiff’s allegations that the contract was with a partnership of which the defendant was a partner. The defendant argued that the contract was with an LLC and that the defendant was not liable absent veil-piercing allegations, but the plaintiff alleged that the LLC was not formed until five months after the contract was executed and that the LLC no longer existed. Taking the allegations as true, the court stated that the plaintiff stated claims against the defendant “[a]s an alleged partner to a contract for which judicial foreclosure is sought on a lien under the Texas Property Code,” relying on the principle that “[a] partner in a general partnership is personally liable for partnership debts jointly and severally with all other partners.”

**C. Limited Liability of Member or Manager; Personal Liability of Member or Manager Under Agency or Other Law**

*Rahlek, Ltd. v. Wells*, 2019 WL 2220600, \_\_\_ S.W.3d \_\_\_ (Tex. App.—Eastland 2019, no pet. h.).

The court held that it was not necessary to rely on veil-piercing principles to argue that an individual’s letter signed in a representative capacity for an LLC waived rights of the individual, but the evidence did not conclusively establish an intent to relinquish the rights, and the trial court did not err in denying the affirmative defense of waiver.

In a dispute regarding the conveyance of mineral and royalty interests, certain claimants to the interests (the “Campbell Children”) argued that another claimant, Ricky Grubbs, intentionally engaged in conduct inconsistent with claiming a right to recover royalties by sending letters to the Campbell Children acknowledging that they owned a royalty interest in land at issue. Grubbs argued that he did not waive his right to recover royalties because the letters were sent on behalf of an LLC that was the operator of the tract and of which he was the sole owner and manager. The court stated that Grubbs appeared to argue that the Campbell Children were required to plead and prove veil piercing to prevail on their affirmative defense of waiver since he engaged in the conduct in a representative capacity.

The court of appeals stated that Grubbs’s reliance on veil piercing was misplaced in that such principles are typically used to impose a corporation’s legal obligation on a shareholder, director, or officer. The court recognized that corporate veil-piercing policies also apply to LLCs; however, the court said there was no need for the Campbell Children to plead veil piercing or allege alter ego because the Campbell Children did not seek to impose individual liability on Grubbs.

The court next rejected Grubbs’s argument that he could not have waived his individual rights to royalties in a letter signed by him in a representative capacity. “The fact that Grubbs directed the letters to be sent in his capacity as an agent (rather than in his individual capacity) does not strip him of the knowledge he possessed when he did so—that the Campbell Children were receiving royalties from and possessed a royalty interest in the Grubbs ‘A’ Lease Tract.” Thus, the court concluded that “with the requisite knowledge and intentional acts, Grubbs could have waived his personal right to recover royalties, in part, by sending the letters to the Campbell Children.” Nevertheless, viewing the evidence in the light most favorable to the verdict, the court concluded it was not clear from Grubbs’s conduct that he intended to relinquish his right to recover royalties from the Campbell Children.

*EcoFriendly Water Co., LLC v. Mercer*, No. 05-18-00763-CV, 2019 WL 1950177 (Tex. App.—Dallas May 2, 2019, no pet. h.) (mem. op.).

An individual was held liable on a loan agreement that he signed without indicating his representative capacity for the LLC.

Jay LaFrance contended that the evidence did not establish his personal liability on a loan agreement that he signed on a signature line labeled “Borrower’s Signature” without indicating his representative capacity for the LLC borrower. LaFrance argued that it was “obvious” that the signature must have been on the LLC’s behalf since the LLC was the borrower. The court concluded, however, that LaFrance had expressly agreed to be personally

liable (an exception to liability protection recognized by Tex. Bus. Orgs. Code § 21.225(1)) because he signed on the signature line labeled “Borrower’s Signature” without indicating his representative capacity and the agreement stated as follows in a section titled “Liability”: “Although this agreement may be signed below by more than one person, each of the undersigned understands that they are each as individuals responsible and jointly and severally liable for paying back the full amount.” The court concluded that this language was unambiguous and that LaFrance expressly agreed to be personally liable for the full amount owed under the loan agreement.

***Bates Energy Oil & Gas v. Complete Oilfield Services***, 361 F. Supp. 3d 633 (W.D. Tex. 2019).

The court held that Tex. Bus. Orgs. Code § 21.224 did not apply to direct claims against an LLC’s managing member for his own alleged tortious acts in connection with a contract entered into by the LLC even though the acts were taken in the managing member’s representative capacity.

In a dispute arising out of the sale of frac sand by Bates Energy Oil and Gas (“Bates Energy”) to Complete Oilfield Services (“COFS”), COFS asserted claims against Equity Liaison Company, LLC (“ELC”) and Dewayne Naumann—ELC’s managing member—for fraud and other torts based on actions taken by Naumann in connection with an escrow agreement among ELC (as escrow agent), COFS, and Bates Energy. COFS alleged claims against Naumann based on individual direct liability as well as vicarious liability under a veil-piercing theory. Although Texas has long recognized that corporate officers and agents may be directly liable for tortious acts taken in the course of their employment, Naumann relied on the preemption provision of Tex. Bus. Orgs. Code § 21.224, and certain recent cases interpreting that provision, for the proposition that he could not be held liable absent proof of the conditions specified by Tex. Bus. Orgs. Code § 21.223(b), i.e., use of the entity for actual fraud for the direct personal benefit of the owner.

The court first reviewed the background and development of the statutory veil-piercing provisions that were added to Article 2.21 of the Texas Business Corporation Act in the aftermath of the *Castleberry* case. The court then summarized the current statutory provisions as follows:

In its current form, codified at Texas Business and Organizations Code § 21.223(a), the statute protects members of corporations and LLCs [the court pointed out in a footnote that corporate veil piercing principles have been held to apply equally to LLCs and that § 21.223 applies to LLCs by virtue of § 101.002] from liability “to the corporation or its obligees with respect to . . . any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder, beneficial owner, subscriber, or affiliate is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory.” TEX. BUS. ORGS. CODE § 21.223. However, § 21.223(b) further provides that a holder, beneficial owner, subscriber, or affiliate is not shielded from liability if he “caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, beneficial owner, subscriber, or affiliate.” *Id.* § 21.223(b).

Thus, § 21.223(b) allows a plaintiff to hold corporate shareholders, beneficial owners, and others responsible for corporate obligations by piercing the veil if they can show the individual committed actual fraud for his direct personal benefit. Further, the statute pre-empts any common-law veil piercing theories, stating that liability “for an obligation that is limited by Section 21.223 is exclusive and preempts any other liability imposed for the obligation under common law or otherwise.” TEX. BUS. ORGS. CODE § 21.224. Section 21.225 then provides “exceptions to limitations,” stating that Section 21.223 or 21.224 “does not limit the obligation of a holder, beneficial owner, subscriber, or affiliate to the obligee of the corporation if that person: (1) expressly assumes, guarantees, or agrees to be personally liable to the obligee for the obligation; or (2) is otherwise liable to the obligee for the obligation under this code or other applicable statute.” *Id.* § 21.225.

The court next pointed out that “‘apart from any veil piercing theory seeking vicarious liability, it has long been established that ‘a corporation’s employee is personally liable for tortious acts which he directs or participates in during his employment’ . . .” and that “[t]he law is well-settled that a corporate agent can be held individually liable for fraudulent statements or knowing misrepresentations even when they are made in the capacity of a

representative of the corporation.’ *Kingston v. Helm*, 82 S.W.3d 755, 759 (Tex. App.—Corpus Christi 2002, pet. denied).” Although direct liability and vicarious veil-piercing liability of corporate agents for acts within the scope of employment have “coexisted for decades” in Texas, the court explained that “recent cases have muddled this distinction” and “fail to demonstrate any consensus.” After a thorough discussion and analysis of the case law addressing direct liability of corporate agents since the advent of the preemption provision in the corporate veil-piercing statute, the court followed *Kingston v. Helm*, 82 S.W.3d 755 (Tex. App.—Corpus Christi 2002, pet. denied), and disagreed with *TecLogistics, Inc. v. Dresser-Rand Group, Inc.*, 527 S.W.3d 589 (Tex. App.—Houston [14th Dist.] 2017, no pet.). The court summarized *Kingston v. Helm* as follows:

In *Kingston v. Helm*, 82 S.W.3d 755 (Tex. App.—Corpus Christi 2002, pet. denied), the court of appeals expressly considered an individual defendant’s assertion that § 21.223 subsumes claims for direct individual liability when the claims arise out of or relate to contractual obligations of the corporation. The individual defendant argued that the statute (then article 21.21) “reversed the caselaw [concerning individual liability for personally participating in torts] and effectively eliminated individual liability for corporate officers and agents who are shareholders in the corporation absent evidence that the corporation itself was specifically used for the purpose of perpetrating a fraud.” *Id.* at 764. Thus, the defendant argued, the statute would apply not only to veil-piercing claims, but also to direct claims attempting to hold a corporate agent individually liable for the agent’s own tortious conduct when the tort claim related to or arose from the corporation’s contractual obligation.

The court held that the plaintiff “was not required to pierce the corporate veil to hold [the individual defendant] liable in his individual capacity.” *Id.* at 761. It concluded that the statute was aimed at traditional veil piercing theories, which seek to hold shareholders and beneficial owners liable merely based on their status as an owner or shareholder, and did “not believe that this article was intended to shield a corporate officer or agent who commits tortious conduct merely because the officer or agent also possesses an ownership interest in the corporation.” *Id.* at 765. “In other words,” it said, “the statute applies to suits which attempt to impose individual liability on a corporate shareholder not on the basis of the shareholder’s own actions, but rather on the basis of the shareholder’s status as a shareholder,” and alter ego and “similar theories” refer to the various theories of veil piercing. *Id.*

In contrast, the court of appeals in *TecLogistics, Inc. v. Dresser-Rand Group, Inc.* concluded that § 21.223 applied to a direct liability claim of common-law fraud against a corporation’s president and shareholder. The court explained its disagreement with *TecLogistics* as follows:

The Court disagrees with *TecLogistics* that the common-law rule of direct personal liability for a corporate agent’s own tortious conduct is superseded by § 21.223 when the tort claim is related to a contractual obligation of the corporation or LLC. The history of the statute and the statutory language indicate that it applies to veil piercing theories (for both contract and related tort claims), but not to direct liability claims for an individual’s own tortious conduct. The protection of subsection (a)(2) applies to “any contractual obligation *of the corporation* or any matter relating to or arising *from the obligation*,” § 21.223(a)(2) (emphasis added), indicating that it applies to claims holding a shareholder or owner liable for a contract-related *corporate obligation* (both contract and tort), the classic veil piercing scenario. Further, it bars claims seeking to hold a shareholder or owner liable for a corporate obligation on the basis that the individual “is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory.” *Id.* As used here, alter ego, actual and constructive fraud, and sham to perpetrate a fraud are veil piercing theories under Texas common law. *Castleberry v. Branscum*, 721 S.W.2d 270, 272 (Tex. 1986).

“Other similar theory” would include other veil piercing theories under Texas common law, of which there are several. See *O’Connor’s Texas Causes of Action* Ch. 38, § F (“Vicarious liability can be imposed on a defendant for certain acts of a corporation under any one of seven theories for disregarding the corporate form, commonly referred to as ‘piercing the corporate

veil.”). But “other similar theory” would not appear to include direct, individual liability claims based on personal conduct, which have always been separate from veil piercing theories. While *TecLogistics* and *Saeed* focus on the language that the statute applies to “any matter relating to or arising from the [corporate contractual] obligation,” neither focuses on the theory of liability language, which indicates that the statute applies to veil-piercing theories of liability, not direct liability theories. Accordingly, the Court will not apply the statute to any direct personal liability claims, and will simply examine those claims to determine whether COFS has sufficiently pled a claim.

The court examined each of the plaintiff’s direct claims against Naumann and concluded that certain fraud claims survived dismissal and certain claims should be dismissed subject to leave to amend. Whether the plaintiff’s direct claim for breach of fiduciary duty should be dismissed presented issues beyond the scope of the motion to dismiss since there were questions as to whether the member owed an actionable duty to the plaintiff separate and apart from ELC’s duty as escrow agent. The court dismissed the negligent misrepresentation claim because the plaintiff failed to allege an independent duty on the part of the member, rendering the negligent misrepresentation claim barred under the rule of *Leitch v. Hornsby* and the economic loss rule.

***Higar v. Task Force of Texas, LLC***, No. 2:17-CV-00060-JRG-RSP, 2018 WL 3849853 (E.D. Tex. July 12, 2018), report and recommendation adopted, 2018 WL 3837862 (E.D. Tex. Aug. 11, 2018).

Task Force of Texas, LLC (“Task Force”) provided repossession services. Albert Anderson owned and operated Task Force and was responsible for implementing the company’s pay practices. Plaintiffs alleged that they were employed by Task Force and were not paid overtime for their work in violation of the Fair Labor Standards Act. Anderson moved to dismiss, in part on the ground that “there is no justification for ‘breaching’ the protections of a limited liability company—i.e., piercing Task Force’s corporate veil.” The court rejected Anderson’s argument: “But Plaintiffs’ Complaint does not allege any veil-piercing theory (e.g., alter ego). Instead, Plaintiffs allege Anderson is liable because of the control he allegedly exerted over Task Force’s pay practices. That is a viable theory for Anderson’s alleged liability. *See* 29 U.S.C. § 203(d) (recognizing that ‘any person acting directly or indirectly in the interest of an employer in relation to an employee’ can be considered an ‘employer’ under the FLSA).”

***Phoneternet, LLC v. Drawbridge Design***, No. 05-17-00890-CV, 2018 WL 3238001 (Tex. App.—Dallas July 3, 2018, no pet.) (mem. op.).

The court of appeals held that the trial court did not err in holding an individual personally liable on a contract that did not indicate the individual’s representative capacity or the legal name of the LLC for which the individual claimed to be acting.

Drawbridge Design sent a contract to “Adam Alfia.” Under Alfia’s name, the word “Maestro” appeared, which was allegedly an assumed name of Phoneternet. The contract was signed by Alfia. “Maestro” did not appear on the signature line, and the words “Phoneternet, L.L.C.” did not appear anywhere in the contract. Alfia claimed that he signed the contract on behalf of Maestro and did not sign in his individual capacity. The court disagreed:

It is well-settled that the law does not presume agency. When an agent seeks to avoid personal liability on a contract he signs, it is his duty to disclose that he is acting in a representative capacity and the identity of his principal as “the person dealt with is not bound to inquire whether or not the agent is acting as such for another.” “When an individual signs a contract without indicating that he is signing in a representative capacity, he is liable on the contract.” “If [a] contract clearly shows on its face that it is the obligation of the person who signed it, parol evidence is inadmissible to show that the person intended only to bind his principal.” . . .

In their first issue, appellants assert “the trial court erred in entering judgment against Alfia individually” because “there is essentially no evidence in the record showing Alfia as the proper party” to the [contract]. In this case, Alfia signed the [contract] using his name and did not insert a company or corporate name showing he was an agent. Drawbridge Design was not bound to “inquire or discover” the principal for whom Alfia allegedly acted. We conclude on its face the

[contract] shows Alfia did not sign in a representative capacity. Therefore, the trial court did not err in concluding Adam Alfia, individually, was liable to Drawbridge Design.

*Stanat v. Wild Purge I, LLC*, Civil Action No. SA-16-CA-00482-FB, 2016 WL 11546299 (W.D. Tex. Oct. 6, 2016), report and recommendation adopted, 2016 WL 11546300 (W.D. Tex. Oct. 27, 2016). (Although the court issued this opinion in 2016, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court recommended that a default judgment be entered against an LLC and its individual managing member based on unpaid overtime wages owed by the LLC under the Fair Labor Standards Act. Liability of the managing member was based on his treatment as an “employer” along with the LLC due to his operational control over the LLC.

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

*Graves v. Lone Star NGL Pipeline LP*, No. 09-18-00173-CV, 2019 WL 962544 (Tex. App.—Beaumont Feb. 28, 2019, no pet. h.) (mem. op.).

The court of appeals affirmed the trial court’s summary judgment in favor of a limited partnership seeking to exercise the power of eminent domain. The court held that authority to make the requisite declaration of necessity had been properly delegated to the CEO of the LLC that was the sole member of the general partner of the limited partnership.

Lone Star NGL Pipeline LP (“Lone Star”) planned to construct a natural gas pipeline that would run through Liberty County, and the route was determined after an engineering and design study. A map of the route was attached to a Consent of Member in Lieu of a Meeting (the “Consent”) signed by Kelcy Warren. Warren was the CEO of Lone Star NGL Asset Holdings II LLC (the “Company”), and the Company was the sole member of Lone Star NGL Asset GP LLC (“Lone Star GP LLC”), the sole general partner of Lone Star. The Consent outlined the relationship of the various Lone Star entities and stated that the Company, as the sole member of the general partner of Lone Star, found and determined “that public convenience, public use and necessity require that it is in the public interest” for Lone Star to acquire the land along the route. Certain landowners were unhappy with the proposed route, which traveled diagonally through their property, and Lone Star began condemnation proceedings after negotiations for an adjustment of the route failed. The landowners sought dismissal of the proceedings, arguing that Lone Star failed to establish necessity because the Consent was not executed by someone with authority to do so. The trial court denied the landowners’ plea to the jurisdiction and motion to dismiss and granted a partial summary judgment in favor of Lone Star pursuant to which the only remaining issue for determination was the amount of just compensation due to the landowners. The landowners appealed.

The landowners challenged the validity of the determination of necessity by contending that Lone Star “presented no evidence that its governing body either determined necessity or delegated authority to exercise eminent domain.” The landowners’ attack focused on Warren’s authority to sign the Consent and the relationship of the various Lone Star entities and their predecessors. The court noted that “a corporation, general partnership, limited partnership, limited liability company, or *other combination of those entities* engaged as a common carrier in the pipeline business for the purpose of transporting oil, oil products, gas . . . or other mineral solutions has all the rights and powers conferred on a common carrier by Sections 111.019-111.022, Natural Resources Code.” Tex. Bus. Orgs. Code Ann. § 2.105. (emphasis added by court). Section 111.019(b) of the Texas Natural Resources Code provides that in exercising the power of eminent domain, common carriers “may enter on and condemn the land, rights-of-way, easements, and property of any person or corporation necessary for the construction, maintenance, or operation of the common carrier pipeline.” The court stated that necessity is presumed from a determination by the condemnor unless a statute requires affirmative pleading and proof. A condemnor has the burden to show that the board of directors or other governing body or authority with power to speak made a determination of necessity, and this showing may be made through a board resolution or other evidence.

The court quoted at length from the Consent, including multiple recitals and resolutions in which the Company (in its capacity as the sole member of Lone Star GP LLC, acting general partner of Lone Star) determined the public necessity of acquiring the landowners’ property.

The landowners complained that Lone Star did not produce corporate documents relating to the authority or structure of the entities in support of the summary judgment but instead produced the affidavit of the secretary

of the Company to prove up the consent. The court noted that the Consent, along with other evidence, revealed “a combination of [Lone Star] entities” engaged in the business of constructing pipelines for the transportation of natural gas liquids as referred to in Tex. Bus. Orgs. Code Ann. § 2.105. The secretary’s affidavit outlined the history and relationship of the Lone Star entities and attached various documents, including the LLC agreements of the Company and Lone Star GP LLC. The LLC agreements addressed the management of Lone Star GP LLC and the powers of the officers of the Company and Lone Star GP LLC. The evidence submitted by Lone Star with its motion for summary judgment established that, at the time Warren executed the Consent, he was the chairman and CEO of the Company (which was formerly known by another name), which was the sole member of Lone Star GP LLC (which was formerly known by another name), which was the general partner of Lone Star (which was formerly known by another name). The landowners argued, however, that Lone Star was required to prove that the governing agreements authorized Warren, as CEO of the Company, to declare a necessity to use eminent domain “singly.”

The court pointed out provisions of the LLC agreement of the Company and actions of the sole member of the Company supporting Warren’s authority and concluded that, even assuming the LLC agreement of the Company did not expressly confer authority on Warren to “singly” sign a Consent determining public necessity, other evidence established that Lone Star and the Company ratified Warren’s declaration of necessity in the Consent. The court thus concluded that Lone Star’s general partner, acting through its sole member, duly determined the public necessity and that the Consent form coupled with the Company’s ratification of the Consent sufficiently established public necessity.

The landowners further argued that the Company was not the sole member of Lone Star GP LLC, but the court concluded that the evidence clearly established that the Company was the sole member of Lone Star GP LLC despite a mistaken reference in the LLC agreement of Lone Star GP LLC.

Finally, the landowners complained that “an officer signed the Consent, not the member, and nothing grants any agent, manager or officer the power of eminent domain.” (Presumably, although it is not entirely clear from the opinion, this reference to “the member” is a reference to the Company itself, as the sole member of the general partner, as opposed to the Company’s member, which was yet another LLC.) While the power to determine necessity for purposes of eminent domain may be validly delegated, the landowners asserted that the officers of the Company lacked express authority to authorize condemnation. The court responded that the evidence made “clear that the member is governed by the officers, who are authorized to act on behalf of the company,” and that the secretary’s affidavit specifically declared that “the general partner of Lone Star NGL Pipeline LP has throughout the Lone Star pipeline project at issue delegated responsibility to officers of the general partner and their designees, including” the engineer whose study was the basis for determining the proposed route. The court further relied on the Delaware LLC statute (the entities were organized in Delaware and agreed that Delaware law would govern their agreements), which provides that, unless otherwise provided in the LLC agreement:

a member or manager of a limited liability company has the power and authority to delegate to 1 or more other persons any or all of the member’s or manager’s, as the case may be, rights, powers and duties to manage and control the business and affairs of the limited liability company. Any such delegation may be to agents, officers and employees of a member or manager or the limited liability company[.]

6 Del. C. § 18-407. The court said that it would interpret the Company’s LLC agreement to grant all necessary powers to the officers to conduct the affairs of the company, unless specifically proscribed, citing 6 Del. C. § 18-1101(b) (“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 landowners argued that the secretary’s affidavit should be ignored because it attempted to redefine the express terms of the LLC agreements of the Company and Lone Star GP LLC. In essence, the landowners argued that orders, resolutions, and minutes were the only acceptable evidence of official company proceedings. The court rejected this argument, stating that the eminent domain statutes do not limit the type of evidence that may be presented by a condemnor in this respect.

In sum, the court concluded that Lone Star conclusively established that authority had been properly delegated to Warren, the CEO of the Company, and that the Consent executed by Warren as the CEO of the sole member of Lone Star’s general partner contained a valid declaration of necessity.

## E. Fiduciary Duties

*MJAH Holdings, LLC v. Henson*, No. 03-18-00012-CV, 2019 WL 1413282 (Tex. App.—Austin Mar. 29, 2019, no pet. h.) (mem. op.).

After a bench trial, the trial court found that an LLC member breached a management and consulting agreement and breached his fiduciary duties to the LLC, but his conduct did not constitute fraud or conversion. The trial court also found that the LLC failed to substantiate its claim for damages resulting from the breach of contract and breach of fiduciary duties to the LLC and thus awarded no damages. The court of appeals reviewed the evidence relating to damages and concluded that the trial court’s failure to award damages was not against the great weight and preponderance of the evidence. According to the appellate court, “[t]here was evidence to support the conclusion that the [LLC’s] business plan failed not because of Henson’s breach of contract or of his breach of fiduciary duties but, rather, was the predictable result of a strategy based largely on the predictions and abilities of an untested entrepreneur who was, by his own admission, overly optimistic about [the LLC’s] prospects.”

*Katz v. Intel Pharma, LLC*, Civ. A. No. H-18-1347, 2018 WL 4701566 (S.D. Tex. Oct. 1, 2018).

Plaintiff’s lawsuit asserted breach of fiduciary duty, aiding and abetting a breach of fiduciary duty, and other claims. The trial court denied a motion to dismiss.

Terry Katz brought a derivative action on behalf of Intel Pharma, LLC against Ntel Pharma, LLC, Ntel Nutra, Inc., and Landon Suggs. Among other claims, Katz asserted breach of fiduciary duty against Suggs and aiding and abetting a breach of fiduciary duty against Ntel Pharma and Ntel Nutra. In essence, Katz claimed that he was a 25% owner of Intel and that Suggs and Angel Echevarria (Intel’s President) stole the business by transferring all or substantially all of Intel’s assets to Ntel Pharma and later to Ntel Nutra.

The defendants moved to dismiss on various grounds, including that Katz’s claims were based on an alleged oral agreement with Suggs to acquire a 25% interest in Intel, and that Katz had not pleaded sufficient facts to support an inference of an enforceable contract. Katz argued, in part, that he alleged facts about the contract simply to show that, because he had a 25% ownership interest, he had standing to bring a derivative suit.

The court observed that Katz’s claims were properly considered under § 101.463 of the Business Organizations Code, which provides special rules for closely held LLCs. Under § 101.463, a “closely held limited liability company” is an LLC with “(1) fewer than 35 members; and (2) no membership interests listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national securities association.” According to the court, Katz alleged that Suggs was the sole owner of Intel before he offered Katz a 25% interest, “meaning that Intel had fewer than 35 members and that its membership interests are not listed on a national exchange.” The court ultimately concluded that Katz’s allegations withstood dismissal:

“Sections 101.452–101.459 [of the Business Organizations Code] do not apply to a closely held limited liability company.” § 101.463(b); *see also Lonestar Logo*, 552 S.W.3d at 348–49. “The import and effect of this exemption, as the Texas Supreme Court has observed in regard to the parallel provisions that govern shareholder-derivative suits, are that ‘the Legislature has enacted special rules to allow its shareholders to more easily bring a derivative suit on behalf of the corporation,’ including ‘without having to prove that they “fairly and adequately represent[ ] the interests of” the corporation, without having to make a “demand” upon the corporation, as in other derivative actions, and without fear of a stay or dismissal based on actions of other corporate actors in response to a demand.’” *Id.* at 349 (quoting *Ritchie v. Rupe*, 443 S.W.3d 856, 880–81 (Tex. 2014) (citations omitted)). Section 101.463 also provides:

[i]f justice requires:

(1) a derivative proceeding brought by a member of a closely held limited liability company may be treated by a court as a direct action brought by the member for the member’s own benefit; and

(2) a recovery in a direct or derivative proceeding by a member may be paid directly to the plaintiff or to the limited liability company if necessary to protect the interests of creditors or other members of the limited liability company.

Even if Intel is a closely held corporation, Katz must establish himself as a member of the LLC to bring a derivative suit. The complaint alleges that Katz had a 25% ownership interest in



Intel and that both Suggs and Echevarria corroborated Katz's interest in writing. A membership interest is a bundle of economic rights in the LLC, including the right to receive distributions. *See* TEX. BUS. ORG. CODE § 1.002(54). The complaint alleges that Katz received the right to income distributions from Intel based on his ownership interest and that he received at least two distributions. Viewing the complaint in the light most favorable to Katz, the factual allegations are sufficient to permit Katz's derivative claims. The fact that Katz repeatedly alleges the existence of a contract with Suggs to receive the ownership interest in Intel does not support dismissal.

The defendants also argued that Texas law did not recognize a claim for aiding and abetting a breach of fiduciary duty. The court noted that the cases cited by the defendants concluded that Texas law did not recognize a cause of action for aiding and abetting fraud, but the cases did not discuss aiding and abetting breach of fiduciary duty. The court then cited a number of cases indicating that Texas does recognize a common-law claim for aiding and abetting a breach of fiduciary duty. According to the court:

Stating a claim for aiding and abetting a breach of fiduciary duty requires pleading: "(1) the existence of a fiduciary relationship; (2) that the third party knew of the fiduciary relationship; and (3) that the third party was aware that it was participating in the breach of that fiduciary relationship." *Meadows v. Hartford Life Ins. Co.*, 492 F.3d 634, 639 (5th Cir. 2007). The amended complaint adequately pleads the existence of a fiduciary duty by alleging that Suggs was the CEO of Intel and by alleging facts about his relationship with, and statements to, Katz about Intel. The complaint alleges that Ntel Pharma and Ntel Nutra, through their officers, Suggs and Echevarria, knew of the fiduciary duties that these men owed Intel and participated in the breach. Katz's supporting factual allegations—that Ntel Pharma used the same marketing strategies, website, and mission statement as well as sold the same products as Intel—make these claims more than "threadbare recitals of a cause of action's elements" that merit dismissal.

***In re Dean***, Case No. 16-43088-mxm-7, 2018 WL 4810700 (Bankr. N.D. Tex. Sept. 29, 2018).

The bankruptcy court rejected the claims of the parties, including breach of fiduciary duty and breach of contract in an LLC setting.

John Lester ("Lester"), Mary Lester, and Nedra Dean formed Staffing Dynamics International, L.P. The primary focus of the business was providing placement and staffing of medical personnel for the partnership's clients. The principals later converted Staffing Dynamics into an LLC (Staffing Dynamics International, L.L.C., or "SDI"). Pursuant to the plan of conversion, John Lester and Nedra Dean became the only two managers and members of SDI, each holding a 50% ownership interest.

Disputes and disagreements between Lester and Dean eventually developed. Dean filed for bankruptcy, and in their Liquidation Complaint, John Lester and/or SDI asserted multiple causes of action against her. (As will be discussed below, Dean sued Lester as well.) In part, Lester alleged that Dean prevented him from performing his duties under the operating agreement and violated his statutory and contractual rights to manage SDI. After discussing each of Lester's allegations, the court concluded that there was no credible evidence to support them. Lester and SDI also alleged that Dean, by acting unilaterally, breached the "Major Decision Clause" of the operating agreement (requiring all members to approve defined "Major Decisions"). Once again, the court found that the allegations lacked merit.

Lester and SDI also asserted a breach-of-fiduciary-duty claim against Dean. The court initially observed that Dean "did not formally concede that she owed a fiduciary duty to a fellow SDI member (John Lester), as opposed to the unquestionable fiduciary duty she owed to SDI." Lester "did not plead or prove an informal fiduciary relationship between John Lester and Nedra Dean to support a finding that Nedra Dean owed him a fiduciary duty. *See Fed. Ins. Co. v. Rodman*, 2011 WL 5921529 (N.D. Tex. Nov. 29, 2011) (stating that there is no formal fiduciary relationship created as a matter of law between members of an LLC, but recognizing that an informal fiduciary relationship may arise under particular circumstances where there is a close, personal relationship of trust and confidence)." The court continued:

Generally, the elements of a claim for breach of fiduciary duty are (1) the existence of a fiduciary duty, (2) breach of the duty, (3) causation, and (4) damages. Although the Texas Supreme

Court has recognized that a plaintiff may not need to prove actual damages when seeking equitable relief, the court has reaffirmed that a plaintiff must show causation and actual damages when asserting a claim for the loss of money. In their breach-of-fiduciary-duty count, John Lester and SDI allege, “As a proximate result of [Dean’s] breach of fiduciary duty, Lester and SDI have suffered economic harm in an amount to be proven at trial.” John Lester and SDI also seek to have this economic claim declared nondischargeable, as discussed below. Therefore, John Lester and SDI must prove damages to support their breach-of-fiduciary-duty claims.

John Lester and SDI allege that Nedra Dean breached her duties of care, honesty, undivided loyalty, and fidelity by “her self-dealing and usurping business opportunities as described herein, including, but not limited to those acts of self-dealing designed to divert business opportunities away from SDI to Dean and her family.” John Lester and SDI do not specify the alleged breaches of fiduciary duty, but the Court assumes that John Lester and SDI are referring to the same self-dealing allegations covered above with respect [to] violations of John Lester’s right to manage and perform his management duties, and breaches of contract. The Court already addressed most of those allegations and found they had no merit.

The court then examined the report of an independent auditor who conducted a forensic audit and accounting of SDI for the years 2012-2014. Lester and SDI asserted that the report revealed that Dean misappropriated assets of Lester and SDI for personal gain. After an extensive analysis of the report’s findings, the court disagreed, largely on the basis that there was no credible evidence of any damages suffered by Lester or SDI, or because there was insufficient credible evidence to support a breach of duty.

Dean also asserted that Lester breached his fiduciary duties to SDI and to her through various misdeeds, and she similarly sued Lester for breach of the LLC agreement. The court rejected her claims:

First, the vast majority of Nedra Dean’s allegations relate to harm that John Lester allegedly caused SDI. Nedra Dean is no longer a member of SDI, and she does not have standing, individually or derivatively, to assert SDI’s causes of action, including breach of a fiduciary duty owed to SDI.

Second, Nedra Dean did not plead or prove an informal fiduciary relationship between John Lester and Nedra Dean to support a finding that John Lester owed her a fiduciary duty.

Third, even if John Lester did owe a fiduciary duty to Nedra Dean herself, Nedra Dean did not provide credible evidence of damages to her individually (including her purported mental anguish), as opposed to derivative harm caused by injury to SDI.

...

[T]he vast majority of Nedra Dean’s allegations relate to harm that John Lester allegedly caused SDI. Nedra Dean is no longer a member of SDI, and she does not have standing, individually or derivatively, to assert SDI’s causes of action, including breach of contract with SDI.

[E]ven if John Lester’s actions could be considered some type of breach of the Limited Partnership Agreement or LLC Agreement, Nedra Dean, as a purported contract-counterparty, did not provide credible evidence of damages to her individually (including purported mental anguish), as opposed to derivative harm caused by injury to SDI.

***Cardwell v. Gurley***, No. 05-09-01068-CV, 2018 WL 3454800 (Tex. App.—Dallas July 18, 2018, pet. denied) (mem. op.).

The court of appeals affirmed the trial court’s judgment that Donald Cardwell had breached his fiduciary duty.

Donald Cardwell and Bill Gurley were each 50% members in 121 Investments, LLC (“121 Investments”). The LLC was member-managed, and it was formed to purchase property and to construct an office building. Cardwell was the managing member, and he had exclusive control and management rights in the company. After Cardwell engaged in various real estate transactions, Gurley sued Cardwell, individually and derivatively on behalf of 121 Investments, for breach of fiduciary duty. The trial court entered a final judgment in favor of Gurley, and Cardwell appealed.

Cardwell argued that the trial court erred in concluding that he owed Gurley a fiduciary duty. He contended that, in a member-managed LLC, he and Gurley did not owe fiduciary duties to each other. Further, he did not owe an informal fiduciary duty “because they were simply businessmen interacting as equals.” Cardwell did not challenge the trial court’s ruling that he owed a fiduciary duty to 121 Investments.

The court of appeals began by discussing the law related to the existence of a fiduciary duty:

To prevail on a claim for breach of fiduciary duty, a plaintiff must establish (1) a fiduciary relationship existed between the plaintiff and defendant, (2) the defendant breached his fiduciary duty to the plaintiff, and (3) the defendant’s breach resulted in injury to the plaintiff or benefit to the defendant. Two types of relationships give rise to fiduciary duties: formal and informal. Fiduciary duties are owed as a matter of law in formal relationships, which include relationships between partners, principals and agents, and attorneys and clients. An informal relationship also may give rise to a fiduciary duty when one person trusts and relies on another, whether the relationship is moral, social, domestic, or purely personal. “A person is justified in believing another to be his fiduciary ‘only where he or she is accustomed to being guided by the judgment and advice of the other party, and there exists a long association in a business relationship, as well as a personal friendship.’” *McAfee, Inc.*, 316 S.W.3d at 829 (quoting *Pabich v. Kellar*, 71 S.W.3d 500, 505 (Tex. App.—Fort Worth 2002, pet. denied)). The existence of an informal fiduciary relationship is usually a question of fact.

Neither the Texas Limited Liability Company Act (TLLCA), which applies to 121 Investments in this case, nor the subsequently-enacted limited liability company provisions of the Texas Business Organizations Code (TBOC) directly address the duties owed by managers and/or members of limited liability companies. Both, however, presume the existence of fiduciary duties, providing that a limited liability company may “expand or restrict” any duties (including fiduciary duties) of a member, manager, officer, or other person.

In its findings and conclusions, the trial court had stated the following: “Cardwell, as the managing member of 121 Investments, owed the LLC fiduciary duties of loyalty and due care as a matter of law. Since Gurley was the only other member of the LLC, such fiduciary duties accrued, and were therefore also owed, directly to Gurley by Cardwell as a matter of law.” The court of appeals largely ducked the question of whether the trial court’s conclusion with respect to Gurley was correct:

The legislature has enacted special provisions allowing shareholders of closely-held corporations and limited liability companies to more easily bring a derivative suit on behalf of the company. The current provision relating to limited liability companies gives a trial court discretion to treat “a derivative proceeding brought by a member of a closely held limited liability company . . . as a direct action brought by the member for the member’s own benefit” and to order “a recovery in a direct or derivative proceeding by a member [to be] paid directly to the plaintiff or to the limited liability company if necessary to protect the interests of creditors or other members of the limited liability company.” BUS. ORGS. § 101.463(c) (West 2012). A closely-held limited liability company is defined as a company with less than thirty-five shareholders and “no shares listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national securities association.” *Id.* at § 101.463(a). Article 5.14(L)(1) of the now-superseded Texas Business Corporations Act (TBCA), and its successor in the TBOC, include the same provision for closely-held corporations. And, at all times relevant to this case, article 8.12 of the TLLCA provided that TBCA article 5.14 also applied to limited liability companies and their members, managers, and officers.

Gurley properly brought his claims individually and derivatively on behalf of 121 Investments, which falls within the definition of a closely-held limited liability company. Both the final judgment and the findings of fact and conclusions of law reflect the trial court’s determination that Gurley was entitled to a direct recovery on both his individual claim and his derivative claim on behalf of 121 Investments for “damages incurred by himself and by 121 Investments as a result of Cardwell’s breaches of fiduciary duties.” And, Cardwell admits he owed a fiduciary duty to 121

Investments. Because the trial court's findings of fact and conclusions of law regarding Ca[r]dwell's fiduciary duty to 121 Investments is sufficient to independently support the trial court's judgment, we need not address whether there is factually sufficient evidence to support the trial court's findings and conclusions regarding Ca[r]dwell's fiduciary duty to Gurley individually.

Cardwell also argued that the trial court erred in finding that he breached his fiduciary duty. He asserted that the company regulations authorized all of his actions as managing member. The court of appeals rejected Cardwell's position: "[The trial court] was free to believe the evidence showing Cardwell's acts vis-à-vis 121 Investments and Gurley, its only other member, were dishonest and self-interested and [free to] disbelieve Cardwell's testimony. Indeed, the findings of fact and conclusions of law make clear that is exactly what happened, and we may not substitute our judgment for that of the trial court. Although the Regulations gave Cardwell broad authority as manager member, as a fiduciary he owed 121 Investments a strict duty of good faith and candor and was prohibited from using the relationship to benefit his personal interests without the principal's full knowledge and consent. Considering and weighing all of the evidence in a neutral light, we conclude the trial court's finding that Cardwell breached his fiduciary duty of loyalty to 121 Investments is not so contrary to the overwhelming weight of the evidence that it is clearly wrong and unjust."

Cardwell also argued that the parties had contractually eliminated liability in the LLC's Articles of Organization. The court of appeals observed that "[a]s with duties, a limited liability company also may expand or restrict a member's or manager's liability to the company or to another member or manager." The Articles of 121 Investments stated that "[n]o member of the Company shall be liable, personally or otherwise, in any way to the Company, its creditors or its members for monetary damages caused in any way by an act or omission occurring in the member's capacity as a member of the Company, except as otherwise expressly provided by Article 1302-7.06B, as amended or the Regulations of the Company." The incorporation of Article 1302-7.06B doomed Cardwell's argument:

Although repealed in 2010, Article 1302-7.06(B) was effective at all times relevant to this litigation, providing:

The articles of incorporation of a corporation may provide that a director of the corporation shall not be liable, or shall be liable only to the extent provided in the articles of incorporation, to the corporation or its shareholders or members for the monetary damages for an act or omission in the director's capacity as a director, except that this article does not authorize the elimination or limitation of the liability of a director to the extent the director is found liable for:

- (1) a breach of the director's duty of loyalty to the corporation or its shareholders or members;
- (2) an act or omission not in good faith that constitutes a breach of duty of the director to the corporation or an act or omission that involves intentional misconduct or a knowing violation of the law;
- (3) a transaction from which the director received an improper benefit, whether or not the benefit resulted from an action taken within the scope of the director's office; or
- (4) an act or omission for which the liability of a director is expressly provided by an applicable statute.

By incorporating the terms of article 1302-7.06([B]), the parties did not contract for "zero liability" as Cardwell asserts. Liability for a breach of the fiduciary duty of loyalty is excepted from the provision's elimination or limitation of liability. Because the evidence supports the trial court's finding that Cardwell breached his fiduciary duty of loyalty to 121 Investments, we overrule Cardwell's fourth issue.

Finally, Cardwell contended that the trial court also erred in failing to apply the business judgment rule to protect him from liability for his actions. The court of appeals observed that "[t]he business judgment rule may protect corporate officers and directors owing fiduciary duties to a corporation from liability for alleged breach of duties based on negligent, unwise, or imprudent acts if the acts were 'within the exercise of their discretion and judgment in the development or prosecution of the enterprise in which their interests are involved,'" but it also noted that "[t]he rule does not protect a corporate officer or director from liability for dishonest, fraudulent, or self-dealing acts." The court concluded that "[b]ecause Gurley specifically alleged, and the evidence supports, the

trial court's findings that Cardwell breached his fiduciary duty to 121 Investments, the trial court's failure to apply the business judgment rule was not error."

***Higher Perpetual Energy, LLC v. Higher Power Energy, LLC***, Civ. A. No. 4:17-CV-00414, 2018 WL 3020328 (E.D. Tex. June 18, 2018).

The court denied a motion to dismiss breach-of-fiduciary-duty claims asserted against defendants Higher Power Energy, LLC ("Higher Power"), Mark Patkunas, Michael Miller, and Lance Wilkerson.

The certificate of formation of Baker Wind Farm, LLC identified Patkunas, Miller, David Tatton, and Wilkerson as its four managers and governing persons. Plaintiff Higher Perpetual Energy, LLC alleged that the defendants, as either a majority member or a manager, breached fiduciary duties to it as a minority owner of Baker Wind. Defendants moved to dismiss the claim.

The court noted that, under Texas law, the elements for a breach-of-fiduciary-duty claim include: (1) a fiduciary relationship between the plaintiff and defendant; (2) the defendant must have breached his fiduciary duty to the plaintiff; and (3) the defendant's breach must result in injury to the plaintiff or benefit to the defendant. The court then observed:

Regarding Higher Power, Plaintiff alleges that "[a]s a majority member of the Baker Project, Higher Power owed Higher Perpetual fiduciary duties . . . Higher Power has breached numerous fiduciary duties it owed to Higher Perpetual . . . Higher Power's breaches have resulted in injury to Higher Perpetual" and "benefited Higher Power." (Dkt. #9 at ¶¶ 49–51). Although the Court views Plaintiff's allegations as true, the Court finds that such allegations are conclusory and insufficient to satisfy the pleading standard. Despite such inadequacy, the Court finds that the appropriate remedy is to allow Plaintiff to replead.

Concerning the Individual Defendants, Plaintiff alleges that Patkunas, Miller, and Wilkerson "[a]s managers of Baker Wind . . . owe fiduciary obligations to Baker Wind Farm, LLC and its shareholder, Higher Perpetual . . . . The Individual Defendants have breached these obligations . . . which resulted in injury to Higher Perpetual." (Dkt. #9 at ¶¶ 54, 61). The Court finds that Plaintiff's allegations are conclusory and insufficient as to how the Individual Defendants breached their alleged fiduciary duties. Nevertheless, the Court finds repleading, rather than dismissal, is the more appropriate remedy.

Although Defendants argue a fiduciary relationship, absent certain circumstances, cannot exist between corporate officers and individual shareholders, the Court addresses this issue in the context of limited liability companies.

"A fiduciary relationship may arise from formal and informal relationships and may be created by contract." *Jacked Up*, 854 F.3d at 808 (quoting *Lundy v. Masson*, 260 S.W.3d 482, 501 (Tex. App.—Houston [14th Dist.] 2008, no pet.)). A formal fiduciary relationship arises as a matter of law and includes relationships between an attorney and client, principal and agent, partners, and joint ventures. *Id.* An informal fiduciary relationship "may arise where one person trusts in and relies upon another, whether the relationship is a moral, social, domestic, or purely personal one." *Id.* (quoting *Navigant Consulting*, 508 F.3d at 283). The Texas Business Organizations Code does not directly address the duties owed by managers and members. Further, "[n]o Texas court has held that fiduciary duties exist between members of a limited liability company as a matter of law." *Entm't Merch. Tech., L.L.C. v. Houchin*, 720 F. Supp. 2d 792, 797 (N.D. Tex. 2010) (citing *Gadin v. Societe Captrade*, No. 08-CV-3773, 2009 WL 1704049 (S.D. Tex. June 17, 2009)); *Suntech Processing Sys., L.L.C. v. Sun Comm., Inc.*, No. 05-99-00213-CV, 2000 WL 1780236 (Tex. App.—Dallas 2000, pet. denied)). As such, "[w]hether such a fiduciary relationship exists is typically a question of fact." *Id.* (citing *Kaspar v. Thorne*, 755 S.W.2d 151, 155 (Tex. App.—Dallas 1988, no writ.)).

As explained above, a formal fiduciary relationship does not exist between managers and members. As such, a fiduciary relationship, if any, must exist via an informal relationship. Because the existence of an informal fiduciary relationship "is a fact-specific inquiry that takes into account the contract governing the relationship as well as the particularities of the relationships between

the parties,” *Gadin*, 2009 WL 1704049, at \*3, the Court declines to dismiss Plaintiff’s fiduciary claims on this ground at this stage in the litigation.

The plaintiff also alleged that, as a member of Baker Wind, it was denied the right to examine the books and records of the company. Defendants moved to dismiss the claim. The court stated that pursuant to § 101.502 of the Business Organizations Code, a member of an LLC maintains the right to examine books and records as specified in § 3.151 and § 101.501. The plaintiff alleged that the defendants refused to permit an examination of the books and records as prescribed by statute, and the court found that those allegations were sufficient to satisfy the pleading requirements.

The plaintiff further alleged that Higher Power committed a conversion by wrongfully exercising dominion and control over the plaintiff’s interest in Baker Wind. Plaintiff alleged that “Higher Power conveyed to Higher Perpetual ‘a 30% membership interest, right, and title in the Baker Project’ . . . [and that such interest] is [Plaintiff’s] personal property.” Further, the plaintiff explained that Higher Power wrongfully exercised dominion and control over such property when it sold it without consent and without proper compensation. The court cited the elements of a conversion claim and concluded that the plaintiff sufficiently pleaded a claim for conversion.

The plaintiff also sought a declaration that “the venture between Higher Perpetual and Higher Power regarding the Baker Wind Farm Project constitute[d] a limited liability company.” The court found that the request for declaratory relief was sufficiently pleaded.

*Nerium SkinCare, Inc. v. Nerium International, LLC*, Civ. A. No. 3:16-CV-1217-B, 2018 WL 2323243 (N.D. Tex. Mar. 26, 2018), report and recommendation adopted, 2018 WL 2323471 (N.D. Tex. May 2, 2018).

The court (via a Special Master) denied summary judgment on a breach-of-fiduciary-duty claim.

Nerium SkinCare, Inc. (“NSC”) manufactured consumer skin care products containing extract from the *Nerium oleander* plant. In early 2010, NSC was introduced to Jeff Olson, an entrepreneur with extensive multi-level marketing experience. NSC and Olson agreed to form a new company, Nerium International, Inc. (“NI”). The only two members of NI were JO Products, LLC (“JOP”), an entity controlled by Olson, which owned 70% of NI, and NSC, which owned the remaining 30% of NI. Olson was the sole manager of NI. NSC was tasked with the testing, production, and delivery of products.

After disputes arose between the parties, Olson moved for summary judgment on NSC’s claim for breach of fiduciary duty. He argued that the derivative claim for breach of fiduciary duty was not properly brought on behalf of NI. The court disagreed:

The only reason given by Olson for dismissing this claim is that NSC does not seek to vindicate any company rights or recover on behalf of NI. However, NSC specifically alleges in its complaint that “Olson’s breaches of fiduciary duty have injured the Company,” and makes clear that it “seeks damages on behalf of the Company[.]” (id. at 44, ¶ 149). Moreover, section 101.463(c) of the Texas Business Organizations Code provides:

(1) A derivative proceeding brought by a member of a closely held limited liability company may be treated by a court as a direct action brought by the member for the member’s own benefit; and

(2) a recovery in a direct or derivative action by a member may be paid directly to the plaintiff or to the limited liability company if necessary to protect the interests of creditors or other members of the limited liability company.

Tex. Bus. Org. Code Ann. § 101.463(c). None of the cases cited by Olson involve this statute or limited liability companies. Summary judgment is not proper on this claim.

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

*Mason v. Mason*, No. 03-17-00546-CV, 2019 WL 1967166 (Tex. App.—Austin May 3, 2019, no pet. h.) (mem. op.).

The court of appeals affirmed the trial court’s determination in a divorce proceeding that a husband wasted community resources based on payment by the husband’s LLC of expenses incurred for the husband’s gambling, travel, hotels, and adult entertainment (such payments being equated by the court as distributions by the LLC during

the marriage). The court of appeals also affirmed the trial court's award of reimbursement of the community estate based on the benefit to the husband's separate-property membership interest inuring from funds loaned to the LLC by the community estate.

At issue in this case were determinations the trial court made in the divorce of Jeff and Keri Mason relating to a single-member LLC owned by Jeff as his separate property. In dividing the community estate, the trial court first found in favor of Keri on a constructive fraud claim based on "wasteful" expenditures by Jeff and reconstituted the community estate by adding over \$752,324 to the community estate. The trial court also characterized Jeff's LLC as separate property and awarded the community estate reimbursement of \$283,051 from Jeff's separate estate for outstanding loans made by the community estate to the LLC.

Keri's claim for constructive fraud was based on expenditures totaling \$752,324 paid by Jeff's LLC for Jeff's gambling, travel, hotels, and adult entertainment during the pendency of the divorce in violation of a standing order that was in effect at the time. The trial court determined that the payment of these expenses by the LLC amounted to a distribution to Jeff, which he wasted to the detriment of the community.

The court of appeals explained that an LLC is a separate legal entity and that the property owned by the LLC is neither separate nor community property. Tex. Bus. Orgs. Code § 101.106(b) ("A member of a limited liability company or an assignee of a membership interest does not have an interest in any specific property of the company."). However, distributions to a member from an LLC during the member's marriage are considered community property even if the membership interest is owned as separate property. Jeff disputed that the payments of the expenses at issue were distributions because the expenditures were charged by Jeff on the LLC's credit card, were paid directly to the vendors, and were treated by the LLC and its accountants as business expenses. The court of appeals concluded, however, that the record fell short of establishing that the expenditures were legitimate business expenditures, and the trial court did not abuse its discretion in finding that Jeff committed constructive fraud.

Next the court addressed Jeff's challenges to the trial court's judgment of reimbursement of the community in the amount of \$283,051 from Jeff's separate estate based on loans totaling \$599,000 from the community estate to the LLC, which was owned by Jeff as his separate property. Jeff asserted that there was no evidence that his separate estate as opposed to the LLC itself benefitted from or was enhanced by the loan. The court made clear that the community estate was not entitled to reimbursement based solely on the fact that Jeff was the sole member and manager of the LLC (noting in a footnote that reverse veil piercing may be applied in exceptional circumstances to characterize property of a corporation as belonging to the community, and pointing out that a claim of alter ego may in some instances have the same effect as a claim for reimbursement). The court disagreed with Jeff, however, as to the sufficiency of the evidence to show that Jeff's separate estate benefitted from the loans to the LLC.

The court of appeals reiterated the point that LLC property is neither community nor separate property and acknowledged that the funds transferred to the LLC were not subject to division on divorce because they became LLC property and lost their community character when they were transferred to the LLC. However, the community estate could seek reimbursement of the transferred funds based on Jeff's membership interest in the LLC, which was property subject to characterization and which was in this case Jeff's separate property. To prevail on her reimbursement claim based on Jeff's membership interest, Keri had to establish that Jeff's membership interest was "benefitted or enhanced" by the community estate. Jeff argued that there was no evidence that his membership interest became more valuable as a result of the loans, or the evidence did not show that any enhanced value amounted to \$283,051. Of the \$599,000 in loans from the community estate to the LLC, \$50,000 was repaid, approximately \$266,000 was used to fund retirement contributions for Jeff and Keri, \$33,051 was used to fund other employees' retirements, and Jeff and Keri disputed whether the remaining funds were repaid in the form of Jeff's salary or were used for "cash flow" for the LLC. The court concluded that the trial court could reasonably have concluded on the record that the loans from the community estate benefitted Jeff's separate-property membership interest.

The court discussed different measures of enhancement in value and concluded that the measure used for "improvements to another marital estate"—the difference between fair market value before and after the improvements—was not applicable to Jeff's membership interest. Rather, like reimbursement claims for uncompensated time and effort expended to the benefit of stock belonging to a marital estate, the court concluded that a reimbursement claim for funds expended to benefit a membership interest belonging to a separate estate may be measured by the cost of the contribution to the community estate. The court of appeals said the evidence was

sufficient to support the finding that the cost of the loans to the community was \$283,051, and the trial court did not abuse its discretion in concluding the contribution cost was the proper measure of reimbursement.

Finally, the court of appeals considered and rejected Jeff's argument that the decision to reimburse \$281,051 to the community estate was inequitable. The court agreed with Jeff that there was some evidence to support his contention that the community received at least some benefit from the loans and Jeff's membership interest in the form of subsequent wages and distributions, but the court said the trial court could have reasonably inferred that the LLC would continue to operate after the divorce as a result of the loans and that Jeff would continue to enjoy the same distribution benefits as part of his separate estate.

***Wyrick v. Business Bank of Texas, N.A.***, 2019 WL 1941839, \_\_ S.W.3d \_\_ (Tex. App.—Houston [14th Dist.] 2019, no pet. h.).

The court of appeals held that the managing members of an LLC, who had guaranteed a loan to the LLC, had standing to assert claims against the lender that arose out of conduct of the lender in procuring the guaranties from the managing members, but the managing members did not have standing to assert claims based on post-default conduct of the lender that damaged the value of the LLC's property and interfered with the LLC's ability to contract with third parties.

A lender made a loan to an LLC that was guaranteed by two individuals. The individuals contended that the lender assured them the lender would execute on the collateral rather than pursue the guaranties in the event of the LLC's default on the loan. The LLC defaulted, and the lender sought to enforce the guaranties rather than foreclose on the collateral. The lender sued the guarantors, and the guarantors asserted counterclaims. The LLC asserted similar claims against the lender, but the LLC and lender agreed to arbitrate those claims pursuant to an arbitration agreement between them. The lender sought summary judgment against the guarantors on their counterclaims on the basis that they lacked standing to assert them as well as that the guarantors' damages were too speculative. The trial court granted summary judgment without specifying the grounds.

The court of appeals first addressed the guarantors' standing to assert counterclaims for fraud, fraud by nondisclosure, negligence, and gross negligence. Because these counterclaims and alleged injuries were based on the lender's wrongful conduct in procuring the guaranties, as opposed to the lender's post-default conduct that was directed at and damaged the LLC, the guarantors had a sufficient personal stake in the controversy to have standing to assert these claims (although the court of appeals ultimately affirmed the trial court's summary judgment against the guarantors on these claims on other grounds).

As to the guarantors' counterclaim for tortious interference with prospective contracts, the court of appeals held that the guarantors lacked standing to assert this claim because the guarantors focused on post-default conduct and sought redress for injury to the value of the LLC's salt water disposal well and the lender's alleged attempts to interfere with the LLC's potential contracts after the LLC defaulted on the loan. The court acknowledged that the guarantors were the sole managing members of the LLC borrower, but the court relied on the principle that "shareholders have no independent right to bring an action for injuries suffered by the corporation even though they may sustain losses indirectly through their ownership interests." The alleged damage to the LLC's well was the LLC's injury, and the guarantors lacked standing to assert these claims on the LLC's behalf. Indeed, the LLC was already asserting these claims in arbitration. Thus, the trial court did not err in granting summary judgment in favor of the lender on these counterclaims.

***Rodriguez v. Cyr (In re Cyr)***, Case No. 18-50102-CAG, Adv. No. 18-05227-CAG, 2019 WL 1495137 (Bankr. W.D. Tex. Apr. 1, 2019).

Because LLC property is not the property of the members, the court rejected the bankruptcy trustee's argument that the transfer of an LLC's assets constituted an indirect transfer by the member of its interest in the LLC for purposes of fraudulent transfer claims.

The bankruptcy trustee alleged that an LLC's transfer of all of its assets to a related LLC (which was owned by a self-settled spendthrift trust of the debtor) constituted a fraudulent transfer by the debtor as owner of the transferor LLC. The trustee argued that the transfer of the transferor LLC's assets was an indirect transfer of the debtor member's interest because it effectively transferred the value of the debtor's membership interest to the self-settled trust. The court rejected the trustee's argument because the property transferred was property of the LLC rather than the debtor. The court explained:



In Texas, “[a] member of a limited liability company . . . does not have an interest in any specific property of the company.” Tex. Bus. Org. Code Ann. § 101.106(b). Therefore, as sole member of OSI, Debtor had no interest in the assets and business transferred from OSI to SA Spine. Accordingly, the Court agrees that the Trustee has failed to allege that [sic] a transfer of an interest of the debtor.

Further, the court rejected the trustee’s argument that it should invoke its equity powers:

The Trustee encourages the Court to use its equity powers to “delve behind the form of the transactions and relationships to determine the substance.” . . . This Court will not use its equity powers to override the law. While this Court may be a court of equity, this Court is of the opinion that equity follows the law.

***Polaris PowerLED Technologies, LLC v. Samsung Electronics America, Inc.***, Civil Action No. 2:17-CV-00715-JRG, 2019 WL 1399927 (E.D. Tex. Mar. 28, 2019).

The party with standing to assert a patent infringement claim with regard to a patent assigned to an LLC by a member of the LLC was the LLC and not the member who contributed and assigned the patent to the LLC, notwithstanding that the member’s rights under the LLC agreement included receipt of 96% of the LLC’s operating cash, a drag along right that in essence could unilaterally force the sale of the LLC, and appointment of a manager who effectively had a veto right over various acts or transactions affecting the LLC’s intellectual property. Despite these governance provisions, the member did not have the ability to directly control the use of the LLC’s patents, and the member’s rights were not sufficient to establish standing on the part of the member.

***Mathis v. Mathis***, No. 01-17-00449-CV, 2018 WL 6613864 (Tex. App.—Houston [1st Dist.] Dec. 18, 2018, no pet. h.) (mem. op.).

The court of appeals held that the trial court in a divorce action did not err in characterizing an interest in an LLC as community property owned by the husband as opposed to being owned by another entity owned by the husband, but the court of appeals reversed the trial court with respect to valuation of these entities, finding that neither the wife’s nor the husband’s opinion on the value of these closely held entities had any evidentiary support.

The trial court granted a divorce to Ronald and Karen Mathis and awarded Ronald ownership interests in two closely held entities while Karen was awarded an equalized judgment. On appeal, Ronald argued that the trial court made various errors with respect to the two closely held entities that resulted in an excessive equalized judgment and manifestly unfair and unjust property division. Among Ronald’s contentions were that the trial court mischaracterized an ownership interest in an LLC as a community asset and treated bank accounts of another entity as divisible community assets.

On appeal, Ronald argued that the trial court mischaracterized as a community asset an ownership interest in Nations Baseball, a closely held LLC. Although Ronald testified at trial that he owned the interest at issue in Nations Baseball, on appeal Ronald argued that Nations Baseball was owned by a corporate entity—South Texas Baseball—which was undisputedly a community-owned entity. Thus, Ronald argued that the trial court should only have divided the interest in South Texas Baseball, not the interests of both entities. The court of appeals reviewed the evidence, which included testimony in which Ronald referred to himself as a “shareholder” in Nations Baseball. Karen also testified that any ownership in Nations Baseball was held by Ronald as community property. The documentary evidence was conflicting with respect to whether Ronald or South Texas Baseball owned the interest in Nations Baseball (K-1 showing South Texas Baseball as having a 19.2% interest in Nations Baseball, Ronald’s inventory describing South Texas Baseball as having a sole asset of a 19.2% interest in Nations Baseball, and a balance sheet of Nations Baseball showing Ronald as a member with a capital account and share of distributions). In view of the conflicting evidence, the trial court did not err in classifying the ownership interest in Nations Baseball as a distinct and divisible community asset.

The court of appeals next discussed the valuation of the interests in Nations Baseball and South Texas Baseball. At trial, neither party presented expert testimony on valuation. The trial court valued the interests of Nations Baseball and South Texas Baseball at the amounts listed by Karen in her inventory, \$200,000 and \$500,000, respectively. Ronald took the position that both entities were worth zero but acknowledged that they could “possibly” be of some value to a potential buyer. Karen’s testimony on value did not match her inventories

and did not align with the manner in which she claimed to have calculated the value. In the course of its discussion, the court of appeals mentioned certain bank accounts that were identified by all parties as accounts of South Texas Baseball but were treated by the trial court as distinct community assets subject to division. In a footnote, the court made the point that corporate assets are owned by the corporation and are not subject to division as part of the community estate absent a finding of alter ego. Karen did not argue alter ego, and there was no mention by the trial court in its findings and conclusions of any theory that would transform the accounts into divisible community property; therefore, there was insufficient evidence for the trial court to list these balances as distinct, divisible community assets.

The court explained that the method used as a general rule to value community property for purposes of division in a divorce is “market value,” but Karen’s valuations were not supported by the market value method for various reasons, the most significant being that they were closely held entities and “the sale of their shares was restricted.” The court stated that “[m]arket value is not an appropriate valuation method when the property being valued is community-owned shares in a closely held entity that are subject to sale restrictions. . . . In that situation, the fair market value is zero, but there are other valuation methods that may be used to determine the value of an interest in a closely held entity.” Ronald’s position that the value of the interests in the entities was zero was consistent with case law regarding the value of shares in a closely held company subject to sale restrictions, but the court reiterated that market value is not an appropriate valuation method in this context. Other valuation methods identified by the court included the actual value of the property to the owner, the comparable sales method, and a method specified in the corporate documents. Neither party attempted to use any of these methods at trial (although the court noted in a footnote that the “shareholder agreement” of Nations Baseball provided a process for valuing a member’s interest for purposes of the company’s buyout of a member’s interest on dissociation of the member). In sum, neither party supplied the trial court with sufficient evidence to perform the task of ordering a just and right division of the community estate. Thus, the appellate court reversed and remanded the property division for further proceedings in the trial court.

*Katz v. Intel Pharma, LLC*, Civ. A. No. H-18-1347, 2018 WL 4701566 (S.D. Tex. Oct. 1, 2018) (“A membership interest is a bundle of economic rights in the LLC, including the right to receive distributions. See TEX. BUS. ORG. CODE § 1.002(54).”).

*In re Marriage of Hudson*, No. 16-18-00011-CV, 2018 WL 4656288 (Tex. App.—Texarkana Sept. 28, 2018, no pet.) (mem. op.).

The court of appeals agreed with the trial court’s conclusion that property transferred from an LLC to one spouse during the marriage was community property.

David Hudson and Frances Ruben were married. Before the marriage, Ruben’s separate estate acquired a 1.95 acre tract of land by adverse possession. During the marriage, Ruben conveyed this land to Franz Events, LLC. Both before and after this conveyance to the LLC, Hudson made significant loans and contributions toward capital and noncapital improvements to the company and the land. Hudson also paid for material and supplies for the company. After Hudson filed for divorce (but still during the marriage), the LLC conveyed the land, structure, and all personal property in connection with the operation of Franz Events to Ruben. The warranty deed evidencing the conveyance showed that Ruben was the grantee, but it did not contain any indication that it was conveyed to her as her separate property or that she paid for the conveyance with her separate property funds.

The trial court concluded that the transferred land, improvements, and property of Franz Events was community property. Ruben challenged the conclusion, but the court of appeals agreed with the trial court:

These findings of fact established that Ruben originally acquired the 1.95-acre tract prior to her marriage. However, when property is conveyed to an entity such as a partnership or limited liability company, it becomes the property of the entity and loses its separate or community character. *Lifshutz v. Lifshutz*, 199 S.W.3d 9, 27 (Tex. App.—San Antonio 2006, pet. denied); *Marshall v. Marshall*, 735 S.W.2d 587, 594 (Tex. App.—Dallas 1987, writ ref’d n.r.e.). Thus, while the 1.95-acre tract was owned by the LLC, it was neither separate property nor community property. This was also true of the structures and personal property acquired by the LLC, both before and during the marriage.

Further, distributions from the LLC “are considered community property, regardless of whether the distribution is of income or of an asset.” *Lifshutz*, 199 S.W.3d at 27 (citing *Marshall*, 735 S.W.2d at 594); *see also Gonzales v. Maggio*, 500 S.W.3d 656, 668 (Tex. App.—Austin 2016, no pet.) (distributions made in winding up of an entity become part of the community estate). Thus, when the LLC conveyed all of its assets to Ruben during the marriage, those assets became a part of the community estate. Consequently, we find that the unchallenged and implied findings of fact support the trial court’s conclusion of law that Ruben failed to meet her burden of proving that the real and personal property connected with the operation of Franz Events was her separate property. We overrule this issue.

***Paull & Partners Investments, LLC v. Berry***, 558 S.W.3d 802 (Tex. App.—Houston [14th Dist.] 2018, no pet.).

“[T]o show a pretended sale involving a condition of defeasance prohibited by the Constitution, there must be proof that: (1) the seller did not intend title to vest in the purchaser; and (2) the transfer involves a condition allowing the seller to reclaim title to the property after the loan is repaid. . . . In sum, none of the evidence on which the Berrys rely shows conclusively that they did not intend to vest title to the Exbury property in Exbury Investments [LLC]. These facts show that the Berrys needed money and decided to convey their homestead property to a newly formed company [Exbury Investments, LLC] for purposes of obtaining a loan using the property as security—a practice not automatically condemned by our Constitution. On this record, it is for the fact-finder to determine whether the Berrys intended to divest themselves of title. . . . The Berrys also failed to establish a condition of defeasance, the second requirement of a void pretended sale. A condition of defeasance is a condition that permits the seller to reclaim title to the property after the debt is paid. . . . [E]quitable title is not the same thing as a condition of defeasance. We recognize that in some circumstances, the members of a limited liability company have equitable title—the power to compel transfer of legal title—to the company’s property. *See AHF-Arbors at Huntsville I, LLC v. Walker Cnty. Appraisal Dist.*, 410 S.W.3d 831, 839 (Tex. 2012). Yet even if the Berrys could voluntarily dissolve Exbury Investments at any time and on any terms they choose, those facts would not show a condition of defeasance: a pre-existing understanding that the Berrys would dissolve Exbury Investments on specific terms when a certain condition occurred. Accordingly, there is no evidence—much less conclusive evidence—of a condition of defeasance. Because the Berrys did not conclusively establish the two requirements of a pretended sale, the trial court erred in granting summary judgment declaring the conveyance from the Berrys to Exbury Investments void . . . .”

***Nguyen v. Bank of America***, No. 17-20758, 2018 WL 3097178 (5th Cir. June 22, 2018).

“These public records indicate that the property at issue is wholly owned by Tri Investment Group, LLC, not Nguyen [an individual]. Even if Nguyen is the manager of Tri Investment Group, LLC, ‘[a] member of a limited liability company or an assignee of a membership interest in a limited liability company does not have an interest in any specific property of the company.’ Tex. Bus. Orgs. Code § 101.106(b). Therefore, he [Nguyen] lacks standing to pursue his appeal.”

***Higher Perpetual Energy, LLC v. Higher Power Energy, LLC***, Civ. A. No. 4:17-CV-00414, 2018 WL 3020328 (E.D. Tex. June 18, 2018).

The court denied a motion to dismiss a claim of conversion asserted against defendants Higher Power Energy, LLC (“Higher Power”), Mark Patkunas, Michael Miller, and Lance Wilkerson.

The certificate of formation of Baker Wind Farm, LLC identified Patkunas, Miller, David Tatton, and Wilkerson as its four managers and governing persons. The plaintiff alleged that Higher Power committed a conversion by wrongfully exercising dominion and control over the plaintiff’s interest in Baker Wind. Plaintiff alleged that “Higher Power conveyed to Higher Perpetual ‘a 30% membership interest, right, and title in the Baker Project’ . . . [and that such interest] is [the plaintiff’s] personal property.” Further, the plaintiff explained that Higher Power wrongfully exercised dominion and control over such property when it sold it without consent and without proper compensation. The court cited the elements of a conversion claim and concluded that the plaintiff sufficiently pleaded a claim for conversion.

***Infante v. Law Office of Joseph Onwuteaka, P.C.***, 735 Fed. App'x 839 (5th Cir. 2018).

A lawyer who owned and managed an LLC that bought debts and referred them to the lawyer for collection argued that he owned the debts and was not collecting another's debts for purposes of the Fair Debt Collection Practices Act ("FDCPA"). The court rejected this argument because the LLC was a separate entity, and a member of an LLC does not have an interest in any specific LLC property. Tex. Bus. Orgs. Code § 101.106. Thus, the lawyer was collecting "debts . . . asserted to be owed or due another" for purposes of the FDCPA.

***Galaz v. Galaz***, 850 F.3d 800 (5th Cir. 2017).

The court affirmed the district court's judgment awarding the assignee of an LLC membership interest actual and exemplary damages based on the fraudulent transfer of the LLC's assets by the assignee's ex-husband, from whom the assignee had received her membership interest in their divorce.

When Lisa and Raul Galaz divorced, Lisa was awarded half of Raul's 50% membership interest in Artist Rights Foundation, LLC ("ARF"), which held certain music royalty rights. After the divorce, Raul transferred the LLC's royalty rights to Segundo Suenos, which was not organized as an entity at the time but was later organized as an LLC owned by Raul's father. After Lisa filed for bankruptcy, she brought this adversary proceeding against Raul, his father, and Segundo Suenos, LLC ("Segundo"), alleging a fraudulent transfer of the assets of ARF to Segundo that defrauded Lisa of her interest in ARF. After a bench trial, the bankruptcy court found that the transfer of assets from ARF to Segundo Suenos was invalid and that it was a fraudulent transfer under the Texas Uniform Fraudulent Transfer Act. The bankruptcy court held Raul and Segundo liable and awarded actual and exemplary damages to Lisa. After an appeal to the district court and remand back to the bankruptcy court, the bankruptcy court awarded actual and exemplary damages consistent with the district court's instructions, and the defendants again appealed to the district court, which affirmed. On appeal to the Fifth Circuit, the appellate court determined that Lisa's claims were non-core bankruptcy claims and remanded for the district court to enter final judgment after further consideration. After further proceedings that included findings of fact and conclusions of law by the bankruptcy court, the district court adopted those findings of fact and conclusions of law, invalidating the transfer of assets from ARF to Segundo and awarding Lisa actual and exemplary damages. Raul and Segundo again appealed.

In this opinion, the Fifth Circuit affirmed the district court, concluding that "[t]he district court did not clearly err in adopting the bankruptcy court's finding of fraudulent intent. The presence of [six] badges of fraud is sufficient evidence that Raul transferred ARF's royalty rights with the actual intent of defrauding Lisa of her 25 percent economic interest in ARF." The appellate court found no error in the district court's award of \$241,309 in actual damages and \$250,000 in exemplary damages against Raul and Segundo.

## **G. Admission of Members**

***Adelman v. Peter***, Civ. A. No. L-08-6, 2012 WL 13055150 (S.D. Tex. Feb. 3, 2012) (Although the court issued this opinion in 2012, it is included in this year's update because it did not appear in the Westlaw database until recently.)

The court concluded that defendants Michael Peter and Joseph Annecca were members in Dynamic Publishing and Distributing, LLC. The court's analysis focused on a 2002 operating agreement (that selected Delaware law as controlling) that listed the defendants as members owning certain percentages of Dynamic. (The court cited various provisions of the Delaware LLC statute, as well as Delaware cases, to support its analysis.) Moreover, the court found that the interactions between the parties themselves demonstrated a belief that the defendants owned an interest in Dynamic. The court also noted that the federal tax returns filed for calendar years 2002 through 2005 burdened the defendants as though they owned membership interests in the LLC. For these reasons, the court concluded that the defendants acquired a membership interest in Dynamic in 2002.

## H. Interpretation and Enforcement of Company Agreement

### 1. Financial Rights

*Lion Co-Polymers Holdings, LLC v. Lion Polymers, LLC*, No. 01-16-00848-CV, 2019 WL 1285115 (Tex. App.—Houston [1st Dist.] Mar. 21, 2019, no pet. h.) (mem. op.).

The court of appeals affirmed the jury’s breach-of-contract finding with respect to the distribution provisions of a company agreement.

Lion Co-Polymer Holdings, LLC (the “Company”) was a Delaware limited liability company and a manufacturer of synthetic rubber for the automotive and construction industries. Pursuant to the amended company agreement, the members shared in the Company’s profits and proceeds through tiered distribution provisions, or “waterfalls,” based on the type and quantity of their membership interests in the Company. In 2007, the Company admitted Lion Polymers, LLC (“LP”) as a member and issued it a number of Class 1 Preferred Units and Class 3 Common Units.

Because a member might incur tax liability on profits not actually distributed, section 6.01(d) of the company agreement provided for certain “Tax Advances” as follows:

On each Tax Distribution Date, the Company shall, to the extent the Board determines such amounts to be available for distribution, make distributions to the Members in such amounts as the Board determines are sufficient to satisfy the Members’ projected estimated income tax liability with respect to the Company’s income allocable to their Units for such period. . . . Such tax liability will be calculated as though each Member were an individual residing in the State of New York based upon the highest marginal income tax rates, taking into account U.S. federal, state, and local income taxes . . . , which the Board estimates are applicable, utilizing the respective rates for ordinary income or capital gains, depending on the characterization of the Company’s estimated income for such period. Any distribution made to a member pursuant to this Section 6.01(d) *shall be treated as an advanced distribution of, and shall reduce, the amounts next distributable to such Member* pursuant to Section . . . 6.02.

Section 6.02 of the company agreement governed the distribution of proceeds after a “Recapitalization Transaction,” defined as the financing of certain debt exceeding a stated threshold. Section 6.02(1) generally provided:

- (a) First, to the Holders of Class 4 Common Units in an amount equal to the amounts owed to such Holders . . . .
- (b) Next, to the Holders of Class 1 Preferred Units until their Unpaid Class 1 Return is eliminated; . . . .
- (c) Next, to the Holders of Class 1 Preferred Units until their Unreturned Class 1 Capital is eliminated; . . . .
- (d) Thereafter, to the Holders of Class 2 Common Units, Class 3 Common Units, and Class 4 Common Units (but not the holders of Class 1 Preferred Units) pro rata in proportion to the number of such Units.

The Company distributed the proceeds from two Recapitalization Transactions, one in September 2011 (the “2011 Distribution”) and the other in March 2013 (the “2013 Distribution”). LP disputed that it had received its proper share of the proceeds in the 2011 and 2013 Distributions and sued the Company for breach of contract. LP argued that the Company breached the company agreement by withholding \$361,295 in section 6.01(d) tax advances twice—once from LP’s portion of the 2011 Distribution and again from LP’s portion of the 2013 Distribution. The trial court entered a judgment on the verdict, awarding LP \$361,295 in damages for the Company’s breach of the company agreement. The Company appealed, challenging the legal sufficiency of the evidence supporting the jury’s verdict.

The court of appeals held that the evidence was legally sufficient to support the jury's verdict. First, the court considered pertinent witness testimony. In support of its argument that it did not breach the company agreement, the Company relied on the testimony of several individuals. Rich Furlin, the Company's secretary and Tax Matters Member, testified that it was his responsibility to calculate tax advances and distributions and ensure their accuracy; that he used a series of spreadsheets for his calculations and, though some of his initial spreadsheets contained errors, the Company did not use those incorrect calculations; that the Company used his spreadsheet to make the 2011 Distribution under section 6.02; and that there was no double-deduction of tax advances. However, Furlin later testified that the Company used a spreadsheet created by its attorney, Corby Brooks, to make the 2011 Distribution. The Company accountant initially testified that it was Furlin, and not Brooks, who created the spreadsheet for the 2011 Distribution before noting that he had used Brooks' calculations. The jury also heard testimony from an owner and manager of LP, who testified that Furlin's calculations were incorrect because none of the tax advances that LP had received prior to the date of the 2011 Distribution had been deducted in accordance with section 6.01(d). LP's tax attorney, Robert Phillipott, testified that he had analyzed the actual distributions to understand whether the company agreement had been properly followed and concluded that there were "material differences" in amounts that should have been distributed through the 2011 Distribution.

Next, the court considered other portions of the record. Reading sections 6.01(d) and 6.02 together, the court noted that the parties agreed that the Company would advance sufficient cash to LP to satisfy LP's estimated income tax liability and then recoup the tax advances from LP in a *subsequent* non-tax distribution of proceeds under section 6.02 by reducing the amount of that later distribution. The parties did not dispute that the company agreement did not authorize the Company, in making section 6.02 distributions, to deduct future tax advances. However, the record showed that LP's share of the 2011 Distribution was paid on September 9, 2011, and included \$361,295 in deductions for tax advances for the third and fourth quarters 2011 (\$313,328 and \$47,967, respectively). The record also showed that the Company paid LP its third quarter 2011 tax advance on September 15, 2011, and fourth quarter 2011 tax advance in January 2012. Thus, at the time of the 2011 Distribution, the Company had not yet paid either tax advances to LP for the third and fourth quarters of 2011. Furthermore, the parties did not dispute that the Company also deducted from LP's share of the 2013 Distribution these same third and fourth quarter tax advances.

The court determined that the jury could have reasonably resolved the conflicting evidence and testimony. Therefore, the court concluded that there was more than a scintilla of evidence to support the jury's findings that the Company breached the company agreement by twice deducting the tax advances applicable to the last two quarters of 2011 and that LP suffered damages in the amount of \$361,295.

***Lee v. Global Stainless Supply, Inc.***, No. 01-17-00865-CV, 2018 WL 6684854 (Tex. App.—Houston [1st Dist.] Dec. 20, 2018, pet. denied, pet. rehearing filed) (mem. op.).

The court of appeals affirmed the trial court's summary judgment against two minority interest holders in a Delaware LLC on their claims for breach of contract, noncompliance with Delaware's implied covenant of good faith and fair dealing, and Delaware statutory violations.

Two brothers, Danial and Stanley Lee (the "Lees"), sued Forgings, Flanges & Fittings, LLC, a Delaware limited liability company ("the LLC") and the LLC's majority interest holder, Global Stainless Supply, Inc. ("Global"), alleging Global had breached the parties' agreements by forcing the sale of the Lees' membership interests in the LLC for a negative purchase price and by refusing to make distributions to the Lees of more than \$6 million. Global characterized the Lees' suit as an attempt to get a new deal after the LLC's deteriorating financial performance left them empty-handed. In this summary-judgment appeal, the Lees contended that fact issues precluded summary judgment on their claims against Global and the LLC for breach of contract, noncompliance with Delaware's implied covenant of good faith and fair dealing, and Delaware statutory violations.

The Lees built a successful business with a German supplier, and eventually the Lees became the majority owners. In 2006, the Lees sold the assets of the business for more than \$15 million to the LLC, which was newly formed for purposes of the acquisition by Global, a wholly owned subsidiary of Sumitomo Corporation of Americas ("Sumitomo"). Sumitomo was a master distributor of stainless steel products to the oil-and-gas industry, and Global's acquisition of the Lees' business positioned the newly formed LLC to supply a greater variety of steel products and capture additional market share.

As part of the acquisition of the Lees' business, the parties executed two agreements that were the primary subjects of the appeal: (1) the Limited Liability Company Agreement of Forgings, Flanges & Fittings, LLC (the

“LLC Agreement”) between the Lees and Global, and (2) the Put/Call and Members’ Agreement (the “Put/Call Agreement”) among the Lees, Global, and the LLC. While the Put/Call Agreement provided that it was governed by Texas law, the LLC Agreement was governed by Delaware law.

The LLC Agreement provided for voting and non-voting membership interests and gave Global an 85% voting interest and the Lees each a 7.5% nonvoting interest. Although the Lees were hired to run the LLC, the LLC Agreement did not grant them any special authority to participate in the LLC’s management beyond their role as executives, and the agreement provided that Global was the LLC’s manager.

The LLC Agreement provided for two types of distributions—(1) pro-rata distributions of Net Cash Flow and (2) distributions to cover estimated tax liabilities. An amendment to the LLC Agreement in 2014 clarified the computation and timing of tax liability distributions, but the LLC Agreement continued to provide, as it had from the outset, that Net Cash Flow distributions were to “be paid at such time as determined by the Manager.”

The Put/Call Agreement granted a put option to the Lees and a call option to Global. In the event Global terminated the Lees’ employment without cause and exercised its call option later than the LLC’s third anniversary, the price for the Lees’ membership interests was to be determined using a formula based on the LLC’s EBITDA and “Net Debt” at the “Determination Date.” During negotiations, the Lees proposed adding language to the Put/Call Agreement that would have established a floor price for the Lees’ membership interests, but there was no indication Global accepted this language, and it never became part of the Put/Call Agreement.

According to the Lees, the LLC performed well during the period from 2006 to 2014; according to Global, the LLC’s financial condition had substantially deteriorated due to overexpansion. In 2015, Global terminated the Lees’ employment without cause and gave the Lees notice of its intention to call their interests under the Put/Call Agreement for a purchase price calculated using the LLC’s internally prepared financial statements, which were included in Global’s consolidated financial statements and audited by Global’s auditor KPMG. The calculation yielded a negative value for the Lees’ interests because of the LLC’s substantial debt. Thus, according to Global, it owed no contractual obligation to pay the Lees any amount to purchase their membership interests. Global also took the position that the Lees were not owed any unpaid Net Cash Flow distributions even though Global, as the LLC’s manager, had never paid any such distributions. The only past distributions were for tax liabilities.

The Lees sued Global and the LLC, alleging that Global had improperly refused to pay Net Cash Flow distributions and erroneously calculated the purchase price for their interests. Among the errors asserted by the Lees were inclusion of loans from Sumitomo in Net Debt when the loans should have been excluded as “trade payables” or treated as a cash management system between affiliated companies, and use of the consolidated financial statements instead of basing the calculation on an independent, stand-alone audit of the LLC. According to the Lees, Global’s errors deprived them of unpaid distributions of more than \$6 million under the LLC Agreement and almost \$10 million under the Put/Call Agreement for their LLC membership interests. Based on these allegations, the Lees asserted numerous causes of action. Global and the LLC denied the allegations and asserted counterclaims, but Global retained the independent accounting firm of Briggs & Veselka (“B & V”) to audit the LLC’s financial statements. The B & V audit was completed almost two years after Global exercised its call option, and, like the consolidated KPMG audit, yielded a negative price for the Lees’ interests. Global and the LLC moved for a traditional and no-evidence summary judgment on all the Lees’ claims, and the trial court granted summary judgment against the Lees on all their claims.

The Lees appealed the dismissal of their claims for breach of the Put/Call Agreement, the LLC Agreement, and Delaware’s implied covenant of good faith and fair dealing, and for violations of the Delaware statutes, but they did not appeal the dismissal of other employment, fiduciary-duty, and declaratory-judgment claims.

The Lees contended on appeal that their summary-judgment response raised a fact issue as to whether Global and the LLC incorrectly calculated the purchase price of their membership interests due to improper inventory charges, miscalculation of certain expenses, erroneous inclusion of the Sumitomo loans as part of Net Debt, and improper calculation of cash equivalents. The court of appeals did not find it necessary to consider whether such discrete fact issues existed because the court concluded that the contractual obligation of Global and the LLC under the Put/Call Agreement was to draw the “Formula Price” calculation from the LLC’s audited financial statements prepared in accordance with GAAP, and the record conclusively established that they did this. As the court explained:

Under the Put/Call Agreement, the Lees agreed to sell their membership interests to Global for an agreed-to price using a formula of  $(EBITDA \times 4) - \text{Net Debt} \times \text{the Lees' Interest}$

Percentage). The Lees refused to accept Global's initial calculation of Formula Price because it was not based on audited financial statements of the LLC as a stand-alone entity. Section 3.3(b) of the Put/Call Agreement provides that, "[i]f a Call Exercise Notice is delivered pursuant to the foregoing clause (a) of this section 3.3, then [the LLC] shall cause to be audited its financial statements (i) in the case the Formula Price shall be used to determine the purchase price of the Interests[.]" The contractual definitions of both EBITDA and Net Debt make specific reference to audited financial statements, with the Net Debt definition specifically referencing audited financial statements prepared pursuant to Section 3.3(b). Thus, the Put/Call Agreement memorializes the parties' unambiguous agreement that the key metrics in the Formula Price (EBITDA and Net Debt) would be based on the LLC's audited financial statements prepared in accordance with GAAP.

The record conclusively establishes that Global and the LLC adhered to the Put/Call Agreement's plain text by arranging for an audit to be performed by an independent third-party auditing firm, B & V, and by applying the numbers drawn from the GAAP-audited financial statements directly into the Formula Price calculation. In other words, Global and the LLC followed the contract procedure for exercising the call option. The Lees made no argument in their summary-judgment response that Global and the LLC breached the Put/Call Agreement protocol by failing to act timely. On this record, we find no error in the trial court's summary judgment on the Lees' claim for breach of the Put/Call Agreement.

The Lees argue that the audited financial statements cannot be dispositive of their breach-of-contract claim under the Put/Call Agreement because Section 3.3(e) expressly permits them to "object to [Global's] Call Exercise Notice . . . (whether such objection relates to [Global's] right to deliver the Call Exercise Notice, *the purchase price specified in such Call Exercise Notice* or another reason)[.]" (Emphasis added.) Upon a purchase-price objection, Section 3.3(e) obligated Global and the Lees to "negotiate in good faith to resolve such dispute." And if the dispute was not resolved within ten days after Global delivered the Call Exercise Notice, the Lees and Global had the "right to resort to legal proceedings to resolve the dispute." There is no allegation or evidence that Global did not negotiate in good faith. Thus, we fail to see how Section 3.3(e) precludes summary judgment on the Lees' claim for breach of the Put/Call Agreement. The Lees' competing valuation of the Formula Price may have created a fact issue in a case presenting a different procedural posture—i.e., one where the courts have been asked to render a declaratory judgment as to the correct Formula Price. But that is not the posture in which this case is presented on appeal.

Thus, the court overruled the Lees' challenge to the summary judgment on their claim for breach of the Put/Call Agreement.

The court next addressed the Lees' argument that fact issues—as to whether Global improperly refused to make Net Cash Flow distributions of at least \$6 million for fiscal years 2006 through 2015 when it exercised its call option—precluded summary judgment on their claims for breach of the LLC Agreement, breach of Delaware's implied covenant of good faith and fair dealing, and violation of the Delaware Limited Liability Company Act. Global argued that the LLC Agreement conferred Global, as manager, with exclusive discretion as to whether to pay any Net Cash Flow distributions and that Global's decision to not pay distributions was thus not a breach of any express or implied contractual obligation or statutory violation.

With respect to the Lees' claim for unpaid distributions under the LLC Agreement, the parties disagreed as to how to interpret the distribution provisions in Section 9, which provided in relevant part:

Net Cash Flow of the Company shall be computed and distributed among the Members pro rata in accordance with their respective Membership Interests. Distributions shall be paid at such time as determined by the Manager; provided that Distributions for Estimated Tax Liabilities (as defined below) shall be made quarterly pursuant to Section 9.1. Distribution for Estimated Tax Liabilities shall be subject to a true-up calculation as set forth in Section 9.3. No distributions or returns of capital will be made or paid if they would result in either the Company becoming insolvent or the net assets of the Company becoming less than zero.



Although this clause was followed by detailed provisions addressing the timing and calculation of tax-liability distributions and excesses or shortages as those distributions related to the Lees' actual tax obligations, there was no additional language regarding Net Cash Flow distributions.

The Lees emphasized the mandatory term "shall" in the first sentence of Section 9 to argue that Global could not decide to never distribute Net Cash Flow, but Global relied on language in the second sentence to assert that its exclusive discretion to never pay Net Cash Flow derived from the disparate treatment of Net Cash Flow and tax-liability distributions. Construing Section 9 as a whole and interpreting its plain text, the court concluded that Section 9 could not reasonably be read as contractually obligating Global to pay Net Cash Flow distributions to the Lees at the time of the call:

Section 9's first sentence prescribes the manner of any distributions, instructing that Net Cash Flow distributions (if they are made) must be done "pro rata" in accordance with the members' interests. The "shall" language limits the way in which distributions can be divided (pro rata) when they happen to be made. The sentence's plain terms do not obligate the payment of distributions. The first clause of Section 9's next sentence then addresses when Net Cash Flow distributions will be paid—"at such time as determined by the Manager." Even the Lees acknowledge the discretionary nature of this language.

This language stands in contrast to the language concerning tax-liability distributions. Although Net Cash Flow distributions may be made at such time as determined by the Manager, Global must make tax-liability distributions quarterly. The LLC Agreement's drafters knew how to require distributions to be made at a specific time, but they refrained from doing so for Net Cash Flow distributions.

Section 9 limits Global's discretion in only three ways—(1) Global must make tax-liability distributions quarterly, (2) the tax-liability distributions must be reconciled with the Lees' actual tax obligations annually, and (3) Global may not make any distributions that would cause the LLC to become insolvent or hold less than zero net assets. Other than that part of Section 9 prohibiting Net Cash Flow distributions that would cause the LLC to become insolvent, the LLC Agreement does not impose any restraint against Global's exercise of its timing discretion for Net Cash Flow distributions. Accordingly, Section 9 does not, as the Lees contend, provide any basis for an obligation to pay distributions beyond the mandatory tax-liability distributions.

The discretionary nature of the Net Cash Flow distributions is made even more plain by consideration of Section 9's additional provisions for tax-liability distributions. Not only does the LLC Agreement instruct that tax-liability distributions shall be made quarterly, but it also sets forth, in Subsection 9.1, a "minimum quarterly distributions" calculation and, in Subsection 9.3, a method for "truing-up" any differences between estimated and actual tax obligations. These detailed, specific provisions for tax-liability distributions stand in contrast to those regarding Net Cash Flow distributions. The parties could have stated that Net Cash Flow distributions, like tax-liability distributions, would be made on a certain schedule or at times when Net Cash Flow exceeded a certain sum. But they did not. Under these circumstances, those omissions must be viewed as intentional in ascertaining the parties' intent from what they chose to include and what they chose to omit from their agreement.

As the LLC Agreement is written, Global could breach the contract, for example, by paying distributions in a manner other than pro rata or by failing to make quarterly tax-liability distributions. But we find no basis in the LLC Agreement for the Lees' breach-of-contract claim for unpaid Net Cash Flow distributions at the time Global exercised the call. Accordingly, we overrule that portion of the Lees' third issue challenging the summary judgment on their breach-of-contract claim for unpaid distributions under the LLC Agreement.

The court next addressed the Lees' contention that a fact issue nevertheless existed as to whether Global's refusal to pay Net Cash Flow distributions breached Delaware's implied covenant of good faith and fair dealing because the implied covenant under Delaware law "requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of the contract." The court explained that the implied covenant is "best understood as a way of implying

terms in [an] agreement, whether employed to analyze unanticipated developments or to fill gaps in the contract's provisions.'" Thus, the first step in the court's analysis was to consider whether a gap existed that must be filled. The implied covenant cannot be used to circumvent the parties' bargain; therefore, a party generally cannot assert a claim for breach of the implied covenant based on conduct authorized by the terms of the agreement. "As one court explained, 'For Shakespeare, it may have been the play, but for a Delaware limited liability company, the contract's the thing.' *R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, No. 3803-CC, 2008 WL 3846318, at \*1 (Del. Ch. Aug. 19, 2008) (mem. op.)."

Because the court of appeals had already concluded that the LLC Agreement expressly conferred on Global full discretion as to when and if to distribute Net Cash Flow, the court correspondingly concluded that there was no gap to fill using the implied covenant. The contract itself revealed that the parties considered and specifically addressed how and under what circumstances Net Cash Flow distributions would be made, both when the LLC Agreement initially was executed in 2006 and when its distribution provision was amended in 2014. The court stated that it was not permitted by Delaware law "to employ the implied covenant in a manner that would effectively rewrite the contract to afford the Lees a better deal."

The court addressed post-submission briefing by the Lees in which they cited authority for the proposition that the covenant may operate in equity to restrain the exercise of Global's timing discretion for Net Cash Flow distributions and prohibit unreasonable or unfair acts or omissions even in the absence of contractual gaps. The court stated that this argument did not present a ground for reversal because the court construed it to be a different argument than the Lees made in their summary-judgment response, which focused on the LLC Agreement's construction and the implied covenant's gap-filling function rather than the application of equity to override the LLC Agreement's express terms. Additionally, the court stated that the authorities cited by the Lees indicated that a party "does not act in bad faith by relying on contract provisions for which that party bargained," and the summary-judgment record showed Global's exercise of contractual options for which it bargained and to which the Lees agreed.

Finally, the court addressed the Lees' argument that the trial court erroneously dismissed their claims under the Delaware Limited Liability Company Act for unpaid distributions. After determining that the Lees adequately pleaded the statutory violations and that the claims were live claims that Global and the LLC did not address in their motion, the court of appeals concluded that the trial court's dismissal of the claims was harmless error. The Lees asserted claims for violation of Delaware Limited Liability Company Act § 18-604 (entitled "Distribution upon resignation") and § 18-606 (entitled "Right to distribution"), but the court pointed out that these statutes expressly contemplate that distribution rights are controlled by the LLC Agreement. Section 18-604 states, in pertinent part, that "upon resignation any resigning member is entitled to receive any distribution to which such member is entitled under a limited liability company agreement." Section 18-606 states, in pertinent part, that "unless otherwise provided in a limited liability company agreement, at the time a member becomes entitled to receive a distribution, the member has the status of, and is entitled to all remedies available to, a creditor of a limited liability company with respect to the distribution." Thus, the court's holding that the LLC Agreement imposed no obligation to pay distributions beyond the mandatory tax-liability distributions disposed of this claim.

***Lion Co-Polymers Holdings, LLC v. Lion Polymers, LLC***, No. 01-16-00848-CV, 2018 WL 3150863 (Tex. App.—Houston [1st Dist.] June 28, 2018, pet. filed) (mem. op.).

Appellant, Lion Co-Polymers Holdings, LLC (the "Company"), challenged the trial court's grant of summary judgment for appellee, Lion Polymers, LLC ("LP"), on LP's breach-of-contract claim against the Company. The court of appeals affirmed.

The Company, a Delaware LLC, manufactured synthetic rubber used in the automotive and construction industries. The amended LLC agreement provided that the Company's members would share in the Company's profits through tiered distribution provisions, or "waterfalls," based on the type and quantity of "units," or fractional membership interests in the Company, that each member held. Specifically, section 6.01 of the agreement provided for a waterfall distribution of "Available Funds" as follows:

- (a) Subject to Section 4.02(d)(ii) [applicable to holders of Class 1 Preferred Units] and after giving effect to Section 6.01(b), to the extent the Board determines that (i) the Company has funds on hand available for distribution to the Members (after payment of all then-due obligations of the Company and the establishment of reasonable reserves for the Company's liabilities, obligations,

working capital and other anticipated needs, including any distribution required under Section 6.01(c)) (hereinafter “Available Funds”) and (ii) it is appropriate to make any such distribution of Available Funds, then the Board shall (subject to any contractual or legal restraints that may be applicable to the Company, such as restraints under the Loan and Security Agreement and any other applicable debt covenants) declare and make distributions of Available Funds as follows:

- (i) First, to the Holders of Class 4 Common Units . . . .
- (ii) Next, to the Holders of Class 1 Preferred Units . . . .
- (iii) Thereafter, to Holders of Class 2 Common Units, Class 3 Common Units and Class 4 Common Units pro rata in proportion to the number of such Units; provided, however:

. . . .

(B) Any distribution payable in respect of a Class 3 Common Unit pursuant to this Section 6.01 shall not be distributed in respect of such Class 3 Common Unit (but instead shall be distributed among the other Holders pursuant to the applicable provision of Section 6.01) until the cumulative amount of distributions foregone in respect of such Class 3 Common Unit pursuant to this Section 6.01(a)(iii) is equal to the Strike Price of such Class 3 Common Unit.

(b) Notwithstanding the provisions of Section 6.01, any Available Funds attributable to the receipt of DSM Amounts shall be distributed to the Holders of Class 2 Common Units pro rata in proportion to the number of Class 2 Common Units held.

(c) Notwithstanding the provisions of Sections 6.01(a)(iii), 6.01(b) and 6.02, if at the time of any distribution under Sections 6.01(a)(iii), 6.01(b) and 6.02, the Unreturned Class 5 Capital or the Unpaid Class 5 Return is greater than zero, then any amounts otherwise distributable to Holders of Class 2 Common Units or Class 3 Common Units pursuant to Section 6.01(a)(iii), 6.01(b) or 6.02 shall instead be distributed to Holders of Class 5 Common Units until (i) the Unreturned Class 5 Capital has been reduced to zero and then (ii) the Unpaid Class 5 Return has been reduced to zero.

Section 6.01(d) also provided for certain “Tax Distributions”:

On each Tax Distribution Date, the Company shall, to the extent the Board determines such amounts to be available for distribution, make distributions to the Members in such amounts as the Board determines are sufficient to satisfy the Members’ projected estimated income tax liability with respect to the Company’s income allocable to their Units for such period, including an reallocation of amounts of income to a Member which may occur due to the allocations provided in Section 6.05(a). Such tax liability will be calculated as though each Member were an individual residing in the State of New York based upon the highest marginal income tax rates, taking into account U.S. federal, state, and local income taxes . . . , which the Board estimates are applicable, utilizing the respective rates for ordinary income or capital gains, depending on the characterization of the Company’s estimated income for such period. Any distribution made to a member pursuant to this Section 6.01(d) shall be treated as an advanced distribution of, and shall reduce, the amounts next distributable to such Member pursuant to Section 6.01 or 6.02.

Further, section 6.02 of the LLC agreement provided a distribution waterfall that governed how and to whom proceeds were to be paid after a “Recapitalization Transaction.” The LLC agreement defined a Recapitalization Transaction as “the financing or refinancing of debt secured by the assets of the Company” in an amount in excess of \$10,000,000 in the aggregate and followed by the distribution of all or a significant portion of such amounts to the members existing as of such date.

It was undisputed that, in the summer of 2011, the Company obtained \$300,000,000 in financing that allowed it to refinance its existing debt and to provide \$150,000,000 in distributions to its members. It was also undisputed that LP owned 1,964,492 Class 3 Units at the time of the 2011 Distribution and that the Company deducted \$1,964,492 from its 2011 Distribution to LP as a “Strike Price” deduction. The parties disputed whether the terms of the LLC agreement authorized the strike-price deduction.

The LLC agreement provided that it “shall be governed by, and construed in accordance with, the Laws of the State of Delaware applicable to contracts made and performed in [that] state, without regard to conflicts of law doctrines.” The court of appeals noted that it would “apply Texas procedural law, and . . . apply Delaware law on the issues of contract construction and interpretation.” It further stated that, “[w]ith regard to interpreting the provisions of a limited liability company agreement, as here, ordinary contract interpretation rules apply; the court’s role is to effect the parties’ intent based on the plain meaning of the agreement’s terms.”

The court of appeals began by interpreting the plain meaning of section 6.01(a) of the LLC agreement:

Considering the plain meaning of its terms, section 6.01(a) states that, when the Company determines, based on the specific formula therein, that it has “Available Funds” and that it is “appropriate to make any such distribution of Available Funds,” then the Board “shall,” subject to certain exceptions, “declare and make distributions of Available Funds.” This language is qualified, however, in that the Board shall “declare and make distributions of Available Funds *as follows*: . . . to Holders of . . . Class 3 Common Units . . . pro rata in proportion to the number of such [u]nits; *provided, however*, . . . [that] [a]ny distribution payable in respect of a Class 3 Common Unit pursuant to this Section 6.01 shall not be distributed in respect of such Class 3 Common Unit (but instead shall be distributed among the other Holders pursuant to the applicable provision of Section 6.01) *until the cumulative amount of distributions* foregone in respect of such Class 3 Common Unit *pursuant to this Section 6.01(a)(iii)* is equal to the Strike Price of such Class 3 Common Unit.” (Emphasis added.)

Again, “Delaware adheres to the ‘objective’ theory of contracts, i.e., a contract’s construction should be that which would be understood by an objective, reasonable third party.” The words “provided, however” above, like the words “provided that,” “normally create a condition.” Section 6.01(a) conditions, or qualifies, the distribution of Available Funds to a holder of a Class 3 Common Unit upon the cumulative amount of distributions foregone with respect to that unit being equal to its strike price. Thus, distributions of Available Funds are subject to a strike-price deduction. LP’s summary-judgment evidence shows, and the parties do not dispute, however, that the Company has never made a section 6.01(a) distribution of Available Funds to LP.

The court then turned its attention to section 6.01(d) of the LLC agreement:

Considering the plain meaning of the terms used in section 6.01(d), the parties intent was for “Tax Distributions,” i.e., distributions for “projected estimated income tax liability” to be made, pursuant to the specific formula therein, on “each Tax Distribution Date,” which the Agreement defines as “the date on which estimated federal tax payments are required to be made by calendar year individual taxpayers.” Section 6.01(d) further provides that if the Company makes a tax distribution, it may then reduce the next distribution that it makes under either section 6.01 or 6.02. Notably, the term “strike price” does not appear in section 6.01(d) and nothing in section 6.01(d) states that a tax distribution is subject to the strike-price deduction in section 6.01(a) or makes recoupment of any tax distribution under a subsequent section 6.02 distribution subject to a strike-price deduction.

Thus, nothing in any of the applicable portions of section 6.01 authorize a strike-price deduction. It is undisputed, however, that the Company deducted \$1,964,492 from its 2011 Distribution to LP as a strike-price deduction. Further, the Company, in its responses to LP’s Requests for Admission, admitted that a “\$1.00-per-share strike price was withheld from [LP’s] share” of the 2011 Distribution.

We conclude that the summary-judgment evidence establishes that the Company breached the Agreement by not making the 2011 Distribution to LP in accordance with the applicable terms. Thus, the Company had the burden to come forward with controverting evidence raising a fact issue as to its breach of the Agreement.

The Company, in its summary-judgment response, argued that it was entitled to withhold the strike price from the 2011 Distribution because it had previously made tax distributions to LP under section 6.01(d), which were subject to the strike-price provision in section 6.01(a)(iii) and for which the Company did not previously withhold the strike-price. The Company argued that a tax distribution under section 6.01(d) was subject to a strike-price deduction because section 6.01(a)(iii) provided that “[a]ny distribution payable in respect of a Class 3 Common Unit pursuant to this Section 6.01 shall not be distributed in respect of such Class 3 Common Unit (but instead shall be distributed among the other Holders pursuant to the applicable provision of Section 6.01) until the cumulative amount of distributions foregone in respect of such Class 3 Common Unit pursuant to this Section 6.01(a)(iii) is equal to the Strike Price of such Class 3 Common Unit.” The Company asserted that “section 6.01(d) distributions plainly are ‘pursuant to this Section 6.01.’” The court of appeals, however, rejected the Company’s position:

The Company’s argument attempts to construe subsection (a)(iii) apart from its context. Subsection (a)(iii), when read in context, reveals that it is a condition or qualification placed on distributions of Available Funds:

(a) . . . [T]o the extent the Board determines that [it has Available Funds and it is appropriate to make a distribution] . . . then the Board shall . . . *declare and make distributions of Available Funds as follows:*

. . . .

(iii) Thereafter, to Holders of Class 2 Common Units, Class 3 Common Units and Class 4 Common Units *pro rata in proportion to the number of such Units; **provided, however:***

. . . .

(B) *Any distribution payable in respect of a Class 3 Common Unit pursuant to this Section 6.01 shall not be distributed in respect of such Class 3 Common Unit (but instead shall be distributed among the other Holders pursuant to the applicable provision of Section 6.01) until the cumulative amount of distributions foregone in respect of such Class 3 Common Unit pursuant to this Section 6.01(a)(iii) is equal to the Strike Price of such Class 3 Common Unit.*

(Emphasis added.)

In *Sage Software*, the plaintiff argued, as the Company similarly argues in the instant case, that a clause following a semi-colon and the phrase “provided that” created an independent clause that modified the entire agreement. Conversely, the defendant argued that the phrase “provided that” created a condition that modified only the immediately preceding language. The court noted that the words “provided that” normally create a condition, and it declined to apply the clause outside of the subsection in which it was embedded. The court held that, as a condition, the clause necessarily “modified the preceding text.” Similarly, here, as discussed above, subsection 6.01(a)(iii) modifies the preceding language in section 6.01(a).

Further, the Company’s argument attempts to engraft the strike-price provision in subsection (a)(iii) into subsection (d) in order to authorize a strike-price deduction from a tax distribution. As discussed above, the stated intent of section 6.01(d) is for the Company to provide its members with “Tax Distributions,” i.e., distributions “sufficient to satisfy the Members’ projected estimated income tax liability” with respect to the Company’s income, to allow the members to pay their tax liability on the date on which estimated federal tax payments are required to be made. Engrafting a strike-price deduction into a Tax Distribution, as the Company argues, would render the stated purpose of section 6.01(d) meaningless and illusory in that LP would not actually receive a distribution “sufficient to satisfy [its] projected estimated income tax liability.” “We will not read a contract to render a provision or term ‘meaningless or illusory.’”

Next, the Company argues that the Agreement’s “General Provisions,” at section 11.01, “Offset,” authorize deductions as follows: “Whenever the Company is to pay any sum to any Member, any amounts that such Member, in its capacity as a Member, owes the Company may be deducted from that sum before payment.” As discussed above, however, LP’s summary-judgment evidence shows, and the parties do not dispute, that the Company has never made a section 6.01(a) distribution of Available Funds to LP. Further, nothing in section 6.01(d) authorizes a strike-price deduction. Moreover, “[s]pecific language in a contract controls over general language, and where

specific and general provisions conflict, the specific provision ordinarily qualifies the meaning of the general one.”

We note that the Company, although it asserts that the terms of the Agreement at issue are not ambiguous, largely relies on affidavit, email, and deposition excerpts to support its interpretation of the Agreement. Under Delaware law, when, as here, a contract is not ambiguous, extrinsic evidence may not be used to interpret the parties’ intent.

We conclude that the Company did not meet its burden to bring forth evidence raising a genuine issue of material fact precluding summary judgment on LP’s breach-of-contract claim.

*Anani v. Abuzaid*, No. 05-16-01364-CV, 2018 WL 2926660 (Tex. App.—Dallas June 7, 2018, no pet.) (mem. op.).

The evidence was sufficient to support the jury’s finding that the 80% member of an LLC entered into and breached an agreement with the plaintiff under which: (1) the plaintiff would initially receive a 25% interest in the LLC; (2) the plaintiff’s interest would be increased to 51% in exchange for an additional investment; (3) the plaintiff would be reimbursed for certain expenses; and (4) the plaintiff would be paid a bonus if he worked at the LLC for six months and it became profitable. The court rejected the defendant’s argument that the plaintiff’s claim was barred by Tex. Bus. Orgs. Code § 101.151 (which provides that a person’s promise to make a contribution to an LLC is not enforceable unless the promise is in writing and signed by the person) because the plaintiff did not sue the 80% member for failure to make a contribution, but for his failure to account for the plaintiff’s 51% interest, reimburse the plaintiff for expenses, compensate the plaintiff, and buy out the plaintiff’s interest.

## 2. Purpose of LLC

*Nerium SkinCare, Inc. v. Nerium International, LLC*, Civ. A. No. 3:16-CV-1217-B, 2018 WL 2323243 (N.D. Tex. Mar. 26, 2018), report and recommendation adopted, 2018 WL 2323471 (N.D. Tex. May 2, 2018).

The court (via a Special Master) granted summary judgment on the construction of an operating agreement and denied summary judgment on dissolution and breach-of-fiduciary-duty claims.

Nerium SkinCare, Inc. (“NSC”) manufactured consumer skin care products containing extract from the *Nerium oleander* plant. In early 2010, NSC was introduced to Jeff Olson, an entrepreneur with extensive multi-level marketing experience. NSC and Olson agreed to form a new company, Nerium International, Inc. (“NI”). The only two members of NI were JO Products, LLC (“JOP”), an entity controlled by Olson, which owned 70% of NI, and NSC, which owned the remaining 30% of NI. Olson was the sole manager of NI. NSC was tasked with the testing, production, and delivery of products.

The parties got into a dispute over whether the NI company agreement prevented NI from selling non-NSC products, including Optimera (which NI launched as its own skin care product). The parties all filed motions for summary judgment claiming that the agreement was unambiguous. The court noted that the dispute centered on the proper interpretation of two contract provisions—the purposes clause and the conflicts of interest clause. Those provisions stated:

2.05 Purposes. The primary purposes of [NI] shall be the development, purchase, distribution and sale of all cosmetic and over the counter (“OTC”) products that have been developed, or are in the future developed, by [NSC] and/or its affiliated company, Nerium Biotechnology, Inc. (“Nerium Biotech”), some of which will be utilizing and/or incorporating extracts from the Nerium Oleander, (collectively, the “Product Line”), such Product Line shall include, but not be limited to, those products identified on attached Exhibit “C” and in that certain Perpetual Exclusive Distribution and Licensing Agreement referenced hereafter in Section 4.03, as well as any other lawful purpose which may be undertaken by [NI] in accordance with the applicable provisions of the Texas Business Organizations Code.

6.03. Conflicts of Interest. Subject to the other express provisions of this Agreement and except as provided below, each Manager, Member and officer of [NI] at any time and from time to time may engage in and possess interests in other business ventures of any and every type and

description, independently or with others, including ones in direct competition with [NI], with no obligation to offer to [NI] or any other Member, Manager, or officer the right to participate therein. [NI] may transact business with any Manager, Member, officer or Affiliate thereof, provided the contract or transaction is fair to [NI] as of the time it is authorized or ratified by Manager or Members, as the case may be. Notwithstanding, it is understood and agreed that Olson (hereafter defined), while serving in the capacity of a Manager or officer of [NI], will not, directly or indirectly, own, manage, operate, control, be employed by, perform services for, consult with, solicit business for, participate in, or be connected with the ownership, management, operation or control of any business which produces or distributes cosmetic products which are materially similar to or competitive with the Product Line, provided however, the foregoing obligations shall not impair the ownership, directly or indirectly, of a non-controlling interest in publicly traded companies which produce or distribute any such products.

After discussing rules of contract construction, the court concluded that NI was not prohibited from selling non-NSC products:

Applying these well-established rules of contract construction, the court should determine that neither the purposes clause nor the conflicts of interest clause prohibit NI from marketing and selling Optimera. There is nothing in the plain language of section 2.05 that requires NI to market and sell only NSC products. In fact, that provision imposes no restrictions at all on NI's lawful purposes. Rather, section 2.05 merely recognizes that one of two primary purposes of the company is "the development, purchase, distribution and sale" of cosmetic and OTC products developed by NSC and Nerium Biotech. The other primary purpose of NI is "any [ ] lawful purpose which may be undertaken by [NI] in accordance with the applicable provisions of the Texas Business Organizations Code." When the purposes clause is read as a whole, it cannot be interpreted to create a legally enforceable obligation that requires NI to exclusively market and sell NSC products.

At least one other provision in the Agreement, when read in conjunction with the purposes clause, supports this interpretation. Section 4.03 expressly provides, with limited exceptions, that NI shall be "the sole and exclusive worldwide distributor of the Product Line for [NSC] and Nerium Biotech." The inclusion of this language in section 4.03 is significant because it shows that the parties recognized the importance of exclusivity and the need to expressly provide for it in their contract. The fact that the Agreement expressly makes NI the exclusive distributor of NSC products, but does not expressly require that NI market and sell only NSC products, cannot be ignored. Contrary to NSC's suggestion, exclusive relationships need not work both ways. There is no reciprocal obligation of exclusivity unless the contract provides for one.

Nor does section 6.03 require NI to sell only NSC products. First, section 6.03 imposes no obligations whatsoever on NI. By its terms, the provision applies only to managers, members, and officers of the company. Moreover, like section 2.05, there is nothing in the language of section 6.03 that prohibits or restricts managers, members, and officers from marketing or selling non-NSC products. To the contrary, section 6.03 expressly allows managers, members, and officers to "engage in and possess interests in other business ventures . . . , including ones in direct competition with [NI], with no obligation to offer to [NI] or any other Manager, Member, or officer the right to participate therein." (Id.) (emphasis added). The only limitation on the right to participate in competing business activities applies to Olson . . . . When section 6.03 is read as a whole, it is clear that the limitation on Olson's right to participate in business activities applies to businesses other than NI. The first sentence of section 6.03 refers to "other business ventures." The fact that "notwithstanding" appears at the beginning of the third sentence does not wipe out the first sentence. Rather, "notwithstanding" means that Olson, while serving as sole manager of NI, is more limited than other managers, members, and officers in his ability to pursue "other business ventures" that may be detrimental to the company. The limitation is intended to protect NI, not NSC. Turning that language into a limitation on what Olson can do as the sole manager of the company—thereby limiting what NI can do as well—turns the conflicts of interest provision inside

out. . . . NSC may be disappointed that NI enjoys the benefits of serving as the sole and exclusive worldwide distributor of NSC products with no corresponding obligation on the part of NI to sell only those products. But that is what the Agreement provides.

NSC also sought summary judgment on its claim for judicial wind-up and termination of NI. NSC argued that wind-up and termination was warranted under § 11.314 of the Business Organizations Code, which provides:

A district court in the county in which the registered office or principal place of business in this state of a domestic partnership or limited liability company is located has jurisdiction to order the winding up or termination of the domestic partnership or limited liability company on application by an owner of the partnership or limited liability company if the court determines that:

- (1) the economic purpose of the entity is likely to be unreasonably frustrated;
- (2) another owner has engaged in conduct relating to the entity's business that make[s] it not reasonably practicable to carry on the business with that owner; or
- (3) it is not reasonably practicable to carry on the entity's business in conformity with its governing documents.

In the alternative, NSC argued that the court should recognize a common-law cause of action to terminate a closely held company for breach of the governing documents.

The court noted that judicial dissolution, given its extreme nature, is a limited remedy that courts grant sparingly. The court then denied summary judgment on NSC's claim:

The main argument advanced by NSC to justify the drastic remedy of judicial wind-up and termination is that NI and Olson have frustrated the purpose of the company by selling products that compete with NSC products in violation of the governing documents. However, as explained earlier in this recommendation, the Company Agreement does not prohibit NI or Olson from marketing and selling non-NSC products. NSC also points to its strained relationship with Olson as grounds for dissolving the company. There is no doubt that the relationship between NSC and Olson has deteriorated over time. But section 11.314 requires more than just a disagreement between owners. It requires proof that it is no longer "reasonably practicable" for the parties to carry on business with each other or in conformity with the company agreement. Without suggesting a view of whether NSC may be entitled to an order of judicial wind-up and termination if it prevails on its claims after a trial on the merits, such relief is not proper by way of summary judgment.

### **3. Contractual Modification of Fiduciary Duties**

*Cardwell v. Gurley*, No. 05-09-01068-CV, 2018 WL 3454800 (Tex. App.—Dallas July 18, 2018, pet. denied) (mem. op.).

The court of appeals affirmed the trial court's judgment that Donald Cardwell had breached his fiduciary duty.

Donald Cardwell and Bill Gurley were each 50% members in 121 Investments, LLC ("121 Investments"). The LLC was member-managed, and it was formed to purchase property and to construct an office building. Cardwell was the managing member, and he had exclusive control and management rights in the company. After Cardwell engaged in various real estate transactions, Gurley sued Cardwell, individually and derivatively on behalf of 121 Investments, for breach of fiduciary duty. The trial court entered a final judgment in favor of Gurley, and Cardwell appealed.

Cardwell argued that the trial court erred in finding that he breached his fiduciary duty. He asserted that the company regulations authorized all of his actions as managing member and permitted him to maintain ongoing business interests, including purchasing and selling real estate, outside of 121 Investments. The court of appeals rejected Cardwell's position: "[The trial court] was free to believe the evidence showing Cardwell's acts vis-à-vis 121 Investments and Gurley, its only other member, were dishonest and self-interested and [free to] disbelieve Cardwell's testimony. Indeed, the findings of fact and conclusions of law make clear that is exactly what happened,



and we may not substitute our judgment for that of the trial court. Although the Regulations gave Cardwell broad authority as manager member, as a fiduciary he owed 121 Investments a strict duty of good faith and candor and was prohibited from using the relationship to benefit his personal interests without the principal's full knowledge and consent. Considering and weighing all of the evidence in a neutral light, we conclude the trial court's finding that Cardwell breached his fiduciary duty of loyalty to 121 Investments is not so contrary to the overwhelming weight of the evidence that it is clearly wrong and unjust."

Cardwell also argued that the parties had contractually eliminated liability in the LLC's Articles of Organization. The court of appeals observed that "[a]s with duties, a limited liability company also may expand or restrict a member's or manager's liability to the company or to another member or manager." The Articles of 121 Investments stated that "[n]o member of the Company shall be liable, personally or otherwise, in any way to the Company, its creditors or its members for monetary damages caused in any way by an act or omission occurring in the member's capacity as a member of the Company, except as otherwise expressly provided by Article 1302-7.06B, as amended or the Regulations of the Company." The incorporation of Article 1302-7.06B doomed Cardwell's argument:

Although repealed in 2010, Article 1302-7.06(B) was effective at all times relevant to this litigation, providing:

The articles of incorporation of a corporation may provide that a director of the corporation shall not be liable, or shall be liable only to the extent provided in the articles of incorporation, to the corporation or its shareholders or members for the monetary damages for an act or omission in the director's capacity as a director, except that this article does not authorize the elimination or limitation of the liability of a director to the extent the director is found liable for:

- (1) a breach of the director's duty of loyalty to the corporation or its shareholders or members;
- (2) an act or omission not in good faith that constitutes a breach of duty of the director to the corporation or an act or omission that involves intentional misconduct or a knowing violation of the law;
- (3) a transaction from which the director received an improper benefit, whether or not the benefit resulted from an action taken within the scope of the director's office; or
- (4) an act or omission for which the liability of a director is expressly provided by an applicable statute.

By incorporating the terms of article 1302-7.06([B]), the parties did not contract for "zero liability" as Cardwell asserts. Liability for a breach of the fiduciary duty of loyalty is excepted from the provision's elimination or limitation of liability. Because the evidence supports the trial court's finding that Cardwell breached his fiduciary duty of loyalty to 121 Investments, we overrule Cardwell's fourth issue.

*Nerium SkinCare, Inc. v. Nerium International, LLC*, Civ. A. No. 3:16-CV-1217-B, 2018 WL 2323243 (N.D. Tex. Mar. 26, 2018), report and recommendation adopted, 2018 WL 2323471 (N.D. Tex. May 2, 2018).

The court (via a Special Master) granted summary judgment on the construction of an operating agreement and denied summary judgment on dissolution and breach of fiduciary duty claims.

Nerium SkinCare, Inc. ("NSC") manufactured consumer skin care products containing extract from the *Nerium oleander* plant. In early 2010, NSC was introduced to Jeff Olson, an entrepreneur with extensive multi-level marketing experience. NSC and Olson agreed to form a new company, Nerium International, Inc. ("NI"). The only two members of NI were JO Products, LLC ("JOP"), an entity controlled by Olson, which owned 70% of NI, and NSC, which owned the remaining 30% of NI. Olson was the sole manager of NI. NSC was tasked with the testing, production, and delivery of products.

The parties got into a dispute over whether the NI company agreement prevented NI from selling non-NSC products, including Optimera (which NI launched as its own skin care product). The parties all filed motions for summary judgment claiming that the agreement was unambiguous. The court noted that the dispute centered on the proper interpretation of two contract provisions—the purposes clause and the conflicts of interest clause. Those provisions stated:

2.05 Purposes. The primary purposes of [NI] shall be the development, purchase, distribution and sale of all cosmetic and over the counter (“OTC”) products that have been developed, or are in the future developed, by [NSC] and/or its affiliated company, Nerium Biotechnology, Inc. (“Nerium Biotech”), some of which will be utilizing and/or incorporating extracts from the Nerium Oleander, (collectively, the “Product Line”), such Product Line shall include, but not be limited to, those products identified on attached Exhibit “C” and in that certain Perpetual Exclusive Distribution and Licensing Agreement referenced hereafter in Section 4.03, as well as any other lawful purpose which may be undertaken by [NI] in accordance with the applicable provisions of the Texas Business Organizations Code.

6.03. Conflicts of Interest. Subject to the other express provisions of this Agreement and except as provided below, each Manager, Member and officer of [NI] at any time and from time to time may engage in and possess interests in other business ventures of any and every type and description, independently or with others, including ones in direct competition with [NI], with no obligation to offer to [NI] or any other Member, Manager, or officer the right to participate therein. [NI] may transact business with any Manager, Member, officer or Affiliate thereof, provided the contract or transaction is fair to [NI] as of the time it is authorized or ratified by Manager or Members, as the case may be. Notwithstanding, it is understood and agreed that Olson (hereafter defined), while serving in the capacity of a Manager or officer of [NI], will not, directly or indirectly, own, manage, operate, control, be employed by, perform services for, consult with, solicit business for, participate in, or be connected with the ownership, management, operation or control of any business which produces or distributes cosmetic products which are materially similar to or competitive with the Product Line, provided however, the foregoing obligations shall not impair the ownership, directly or indirectly, of a non-controlling interest in publicly traded companies which produce or distribute any such products.

After discussing rules of contract construction, the court concluded that NI was not prohibited from selling non-NSC products:

Applying these well-established rules of contract construction, the court should determine that neither the purposes clause nor the conflicts of interest clause prohibit NI from marketing and selling Optimera. There is nothing in the plain language of section 2.05 that requires NI to market and sell only NSC products. In fact, that provision imposes no restrictions at all on NI’s lawful purposes. Rather, section 2.05 merely recognizes that one of two primary purposes of the company is “the development, purchase, distribution and sale” of cosmetic and OTC products developed by NSC and Nerium Biotech. The other primary purpose of NI is “any [ ] lawful purpose which may be undertaken by [NI] in accordance with the applicable provisions of the Texas Business Organizations Code.” When the purposes clause is read as a whole, it cannot be interpreted to create a legally enforceable obligation that requires NI to exclusively market and sell NSC products.

At least one other provision in the Agreement, when read in conjunction with the purposes clause, supports this interpretation. Section 4.03 expressly provides, with limited exceptions, that NI shall be “the sole and exclusive worldwide distributor of the Product Line for [NSC] and Nerium Biotech.” The inclusion of this language in section 4.03 is significant because it shows that the parties recognized the importance of exclusivity and the need to expressly provide for it in their contract. The fact that the Agreement expressly makes NI the exclusive distributor of NSC products, but does not expressly require that NI market and sell only NSC products, cannot be ignored. Contrary to NSC’s suggestion, exclusive relationships need not work both ways. There is no reciprocal obligation of exclusivity unless the contract provides for one.

Nor does section 6.03 require NI to sell only NSC products. First, section 6.03 imposes no obligations whatsoever on NI. By its terms, the provision applies only to managers, members, and officers of the company. Moreover, like section 2.05, there is nothing in the language of section 6.03 that prohibits or restricts managers, members, and officers from marketing or selling non-NSC

products. To the contrary, section 6.03 expressly allows managers, members, and officers to “engage in and possess interests in other business ventures . . . , including ones in direct competition with [NI], with no obligation to offer to [NI] or any other Manager, Member, or officer the right to participate therein.” (Id.) (emphasis added). The only limitation on the right to participate in competing business activities applies to Olson . . . . When section 6.03 is read as a whole, it is clear that the limitation on Olson’s right to participate in business activities applies to businesses other than NI. The first sentence of section 6.03 refers to “other business ventures.” The fact that “notwithstanding” appears at the beginning of the third sentence does not wipe out the first sentence. Rather, “notwithstanding” means that Olson, while serving as sole manager of NI, is more limited than other managers, members, and officers in his ability to pursue “other business ventures” that may be detrimental to the company. The limitation is intended to protect NI, not NSC. Turning that language into a limitation on what Olson can do as the sole manager of the company—thereby limiting what NI can do as well—turns the conflicts of interest provision inside out. . . . NSC may be disappointed that NI enjoys the benefits of serving as the sole and exclusive worldwide distributor of NSC products with no corresponding obligation on the part of NI to sell only those products. But that is what the Agreement provides.

NSC also sought summary judgment on its claim for judicial wind-up and termination of NI. NSC argued that wind-up and termination was warranted under § 11.314 of the Business Organizations Code, which provides:

A district court in the county in which the registered office or principal place of business in this state of a domestic partnership or limited liability company is located has jurisdiction to order the winding up or termination of the domestic partnership or limited liability company on application by an owner of the partnership or limited liability company if the court determines that:

- (1) the economic purpose of the entity is likely to be unreasonably frustrated;
- (2) another owner has engaged in conduct relating to the entity’s business that make[s] it not reasonably practicable to carry on the business with that owner; or
- (3) it is not reasonably practicable to carry on the entity’s business in conformity with its governing documents.

In the alternative, NSC argued that the court should recognize a common-law cause of action to terminate a closely held company for breach of the governing documents.

The court noted that judicial dissolution, given its extreme nature, is a limited remedy that courts grant sparingly. The court then denied summary judgment on NSC’s claim:

The main argument advanced by NSC to justify the drastic remedy of judicial wind-up and termination is that NI and Olson have frustrated the purpose of the company by selling products that compete with NSC products in violation of the governing documents. However, as explained earlier in this recommendation, the Company Agreement does not prohibit NI or Olson from marketing and selling non-NSC products. NSC also points to its strained relationship with Olson as grounds for dissolving the company. There is no doubt that the relationship between NSC and Olson has deteriorated over time. But section 11.314 requires more than just a disagreement between owners. It requires proof that it is no longer “reasonably practicable” for the parties to carry on business with each other or in conformity with the company agreement. Without suggesting a view of whether NSC may be entitled to an order of judicial wind-up and termination if it prevails on its claims after a trial on the merits, such relief is not proper by way of summary judgment.

Finally, Olson moved for summary judgment on NSC’s claim for breach of fiduciary duty. He argued that the derivative claim for breach of fiduciary duty was not properly brought on behalf of NI. The court disagreed:

The only reason given by Olson for dismissing this claim is that NSC does not seek to vindicate any company rights or recover on behalf of NI. However, NSC specifically alleges in its complaint

that “Olson’s breaches of fiduciary duty have injured the Company,” and makes clear that it “seeks damages on behalf of the Company[,]” (*id.* at 44, ¶ 149). Moreover, section 101.463(c) of the Texas Business Organizations Code provides:

(1) A derivative proceeding brought by a member of a closely held limited liability company may be treated by a court as a direct action brought by the member for the member’s own benefit; and

(2) a recovery in a direct or derivative action by a member may be paid directly to the plaintiff or to the limited liability company if necessary to protect the interests of creditors or other members of the limited liability company.

Tex. Bus. Org. Code Ann. § 101.463(c). None of the cases cited by Olson involve this statute or limited liability companies. Summary judgment is not proper on this claim.

#### 4. Indemnification and Advancement

*L Series, L.L.C. v. Holt*, 571 S.W.3d 864 (Tex. App.—Fort Worth 2019, pet. filed).

The court of appeals affirmed the trial court’s order that required four limited liability companies to advance to a terminated employee his fees and expenses pursuant to the entities’ governing documents.

Conrad Holt was a member of L Series, L.L.C., CKDH, L.L.C., VUE, L.L.C., and CKDH Investments, L.L.C. (collectively, the “Companies”). He was also employed as the general manager of a group of car dealerships—Arlington Saturn, Ltd., Fort Worth Saturn, Ltd., and Hurst Saturn, Ltd. (collectively, the “Dealerships”). Three of the Companies served as a general partner of one of those Dealerships. CKDH Investments owned and leased the real estate occupied by the Dealerships. Holt had also served as president of each of the Companies and was a manager of CKDH Investments. The other Companies were member-managed.

The Companies and Dealerships terminated Holt’s employment and sued him, claiming in part that he had committed fraud and breached his fiduciary duties to the Companies. Holt counterclaimed, alleging that each of the Companies’ regulations entitled him to advancement of fees and expenses and indemnity. He alleged that the Companies had breached the regulations by failing to provide him advancement and indemnity and refusing to make distributions to him. After amending his counterclaim, Holt sought partial summary judgment with respect to his advancement claim, and the trial court granted Holt’s motion and ordered the Companies to pay Holt’s past “reasonable attorney fees and expenses” and his “future reasonable attorney fees and expenses” on a monthly basis thereafter upon the submission of “summary invoices.” The Companies filed an interlocutory appeal and alternatively sought mandamus relief.

First, the court of appeals concluded that it did not have jurisdiction over the interlocutory appeal of an order requiring advancement. In its analysis, the court disagreed with the Companies’ argument that Delaware law was more expansive than Texas law as to advancement claims:

The Companies argue that we should not consider how Delaware treats advancement claims because its law allowing advancement is more expansive than Texas’s. *See* Del. Code Ann. tit. 6, § 18-108 (allowing indemnification by limited liability company subject only to the standards and restrictions in the company agreement), tit. 8, § 145(e) (allowing corporations to pay defense fees and expenses of officers and directors in advance of final disposition of suit). But Texas law is just as expansive: it provides that a limited liability company’s governing documents may either adopt Texas’s advancement provisions or “may adopt other provisions . . . relating to . . . advancement,” and that those other provisions “will be enforceable.” Tex. Bus. Orgs. Code Ann. § 8.002(b); *see also id.* § 101.402 (providing that a “limited liability company may . . . pay in advance or reimburse expenses incurred by a person,” defined as including a “member, manager, or officer” of the company). Thus, Texas allows a limited liability company the same broad freedom to craft its own advancement provisions as does Delaware. *See Bombardier Aerospace Corp. v. SPEP Aircraft Holdings, LLC*, No. 17-0578, — S.W.3d —, —, 2019 WL 406075, at \*11 (Tex. Feb. 1, 2019) (noting that Texas has “long recognized the strongly embedded public policy favoring freedom of contract” and acknowledging that courts must respect and enforce the terms of a free and voluntary contract “absent a compelling reason”).

Accordingly, although we apply Texas procedure, we have no qualms looking to Delaware law to inform our understanding of the nature of and policies underlying an advancement claim, as did the El Paso Court of Appeals in *Aguilar*, 344 S.W.3d at 46–47.

The court noted that although Texas may not have a specific procedure to deal with advancement claims in the same manner as Delaware, Texas summary judgment procedures are an appropriate procedure for determining a contractual claim as a matter of law. Because the court concluded that an advancement order does not have the character and function of a temporary injunction, and no Texas statute authorizes an interlocutory appeal of an order requiring advancement, the court dismissed the Companies’ appeal of the advancement order; however, the court proceeded to consider the Companies’ alternative request for mandamus relief.

In seeking mandamus relief, the Companies argued that the trial court abused its discretion when ordering advancement because their suit against Holt did not fall within the scope of the advancement provisions in the Companies’ regulations. The Companies acknowledged that Holt was serving as a member when they sued him but contended that their suit was solely for ultra vires acts outside of his capacity as a member. Section 8.02 of the Companies’ regulations contained the following advancement provision:

The right to indemnification conferred in this Article VIII shall include the right to be paid or reimbursed by the Company the reasonable expenses incurred by a *Person of the type entitled to be indemnified under Section 8.01* who was, is or is threatened to be made a named defendant or respondent in a Proceeding [1] *in advance of the final disposition of the Proceeding* and [2] *without any determination as to the Person’s ultimate entitlement to indemnification*; provided, however, that the payment of such expenses incurred by any such Person in advance of the final disposition of a Proceeding, shall be made only upon delivery to the Company of a written affirmation by such Person of his or her good faith belief that he has met the standard of conduct necessary for indemnification under this Article VIII and a written undertaking, by or on behalf of such Person, to repay all amounts so advanced if it shall ultimately be determined that such indemnified Person is not entitled to be indemnified under this Article VIII or otherwise. [Emphasis added.]

Section 8.01 provided “each Person who was or is made a party [to a] pending or completed action, suit[,] or proceeding . . . , by reason of the fact that he or she . . . is or was serving at the request of the Company and an officer, trustee, employee, agent, or similar functionary of the Company shall be indemnified by the Company to the fullest extent permitted by the Act and the TBCA.” Reading these two sections together, the court determined that a person was entitled to advancement if the person was “of the type” entitled to indemnity under section 8.01 and that it was not necessary to determine the right to indemnity.

The Companies argued that Holt was not entitled to advancement under section 8.02 because he would not be entitled to indemnity for his alleged ultra vires acts under section 8.01. Relying on Delaware case law (which refers to the “admittedly maddening” aspect of advancement clauses and “the tsunami of regret that swept over corporate America regarding mandatory advancement contracts”) and distinguishing a Texas case decided in the indemnification rather than the advancement context, the court disagreed with the Companies, concluding that Holt was entitled to advancement because he was “of the type” entitled to indemnity under section 8.01. The court concluded further that requiring Holt to prove that he was ultimately entitled to indemnity, as the Companies argued, would violate the “clear directive” of section 8.02 that the right to advancement was not dependent on a determination of the right to indemnity. The court also determined that the Companies’ allegations of misconduct did not change the nature of the right they bargained to give Holt. Because at least some of the allegations in the suit were based on—and therefore causally connected to—Holt’s service as a member and a manager of the Companies, the court held that the trial court did not abuse its discretion in concluding that Holt was entitled to advancement under the Companies’ regulations.

## 5. Post-employment Restrictive Covenants

*Miner, Ltd. v. Anguiano*, 2019 WL 2290562, \_\_ F. Supp. 3d \_\_ (W.D Tex. 2019).

The court granted a motion for a preliminary injunction enjoining a former managing member/employee of an LLC from competing with the LLC and soliciting its customers in violation of post-employment restrictive covenants contained in the LLC agreement.

The plaintiff sought a preliminary injunction against Anguiano, an individual who had been employed in various capacities by the plaintiff over a period of years and who became a managing member in connection with an acquisition of the plaintiff in 2012. At the time of this acquisition in 2012, Anguiano purchased an interest in the plaintiff pursuant to a subscription agreement that contained noncompete and nonsolicitation covenants for a period of two years from the closing of the sale. A few days after entering into the subscription agreement, the plaintiff and Anguiano entered into an amended and restated LLC agreement that contained noncompete and nonsolicitation covenants for a period of three years after termination of Anguiano's employment with the plaintiff. In 2016, in connection with a promotion of Anguiano, he signed an employment agreement containing noncompete and nonsolicitation covenants for a period of three years after cessation of his employment with the plaintiff. Anguiano voluntarily left his employment with the plaintiff in 2017 and started working as an independent contractor with another company, Paseo Del Norte Dock Products, Inc. ("PDN"). The plaintiff sued Anguiano and PDN for various causes of action, alleging that Anguiano solicited and sold to customers of the plaintiff, took the plaintiff's confidential and proprietary information, and solicited and recruited an employee of the plaintiff to work for PDN. In this opinion, the court addressed the plaintiff's request for preliminary injunctive relief.

The plaintiff sought preliminary injunctive relief based on Anguiano's violation of the noncompetition and nonsolicitation provisions of the LLC agreement and employment agreement and the defendants' alleged misappropriation of trade secrets. The defendants argued that the restrictive covenants relied upon by the plaintiff were unenforceable and that the information allegedly misappropriated did not qualify as trade secrets.

The court first addressed the enforceability of the restrictive covenants in the employment agreement and concluded that the covenants in that agreement lacked consideration and were thus unenforceable. Section 15.50 of the Texas Business and Commerce Code governs the enforceability of covenants not to compete and requires a covenant to be ancillary to an otherwise enforceable agreement and reasonable as to time, geographic area, and scope of activity so as not to impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee. To be ancillary to an otherwise enforceable agreement, the covenant has to be part of an agreement that contains mutual non-illusory promises. Although at-will employment is insufficient consideration to support a covenant not to compete in Texas, courts have found that there is an enforceable agreement supporting a covenant not to compete where an employer promises to provide confidential information to an employee and the employee promises not to disclose the information. The employment agreement contained a confidentiality provision, but the court was not persuaded that this case involved confidential information; therefore, the court concluded that the employment agreement lacked consideration and was unenforceable.

The plaintiff alternatively relied on the restrictive covenants in the amended LLC agreement, which the court concluded was an otherwise enforceable agreement because it contained mutual non-illusory promises. The parties disagreed, however, with respect to the interpretation of the following language in the LLC agreement regarding the duration of the noncompete and nonsolicitation period:

Each Management Member further agrees that, for a period of three (3) years (or such other period as may be specified in the Subscription Agreement or Profits Interest Award Agreement relating to such Management Member) after the cessation or termination of his or her employment . . . .

The plaintiff interpreted this language as providing that the restrictive covenants in the LLC agreement would exist for three years following Anguiano's separation from the plaintiff, but the defendants disagreed, relying on the following phrase: "(or such other period as may be specified in the Subscription Agreement or Profits Interest Award Agreement relating to such Management Member)." The subscription agreement provided that the purchaser was subject to noncompetition and nonsolicitation covenants "[f]or a period set forth next to the name of such Purchaser or Non-Purchaser Stockholder on Appendix A hereto commencing on the date of the Closing . . . ." Appendix A of the subscription agreement listed Anguiano's non-compete period as two years. The defendants argued that there was a conflict between the two agreements and that the period of time set forth in the subscription

agreement controlled based on the language of the LLC agreement. The court focused on the use of the word “or” and concluded that there were two possible options—either a period of three years or a period specified in the subscription agreement. The court acknowledged that whether a contract is ambiguous is a question of law for the court, and the court stated that the language in the LLC agreement appeared at first glance to be ambiguous. The court declined to rule as a matter of law on the applicable duration of the restrictive covenants at this preliminary stage of the litigation. In the interest of justice, the court deferred this matter of contractual interpretation to the summary-judgment stage of litigation, which would permit the court to consider the multiple agreements following the full development of the record and the completion of discovery. Although the court did not resolve the issue of the duration of the restrictive covenant, the court found that the plaintiff established a prima facie case of an enforceable covenant not to compete, and the court proceeded to consider whether the restraints in the restrictive covenant were consistent with Texas law.

The court found the nonsolicitation restriction to be reasonable to the extent it prohibited solicitation of clients Anguiano served while an employee of the plaintiff, but the court took the cautious approach of limiting the geographic area of the covenant not to compete to El Paso County and the country of Mexico pending a judgment on the merits in the case.

Having demonstrated a likelihood of success on the merits on the claims for violation of the restrictive covenants, and having satisfied the other factors required for a preliminary injunction (irreparable harm, balancing of interests, and public interest), the plaintiff was granted preliminary injunctive relief with respect to the restrictive covenants.

The plaintiff failed to convince the court that the information on which it based its trade-secret claims were trade secrets under the Texas Uniform Trade Secrets Act and the federal Defense of Trade Secrets Act.

## 6. Arbitration

*Brown Lab Investments, LLC v. Moesser*, No. 01-16-00837-CV, 2018 WL 3733453 (Tex. App.—Houston [1st Dist.] Aug. 7, 2018, no pet.) (mem. op.).

Appellants, Brown Lab Investments, LLC (“Brown”), Joel Katz, and Andrea Katz (the “Katzes”), challenged the trial court’s order denying their motion to vacate an arbitration award, and granting the motion of appellee, Lane Moesser, to confirm an arbitration award. The court of appeals reversed the judgment of the trial court and remanded for further proceedings so that the trial court could conduct an independent review on the issue of arbitrability.

Align Strategic Partners, LLC (“Align”), a Delaware limited liability company with its principal place of business in Houston, Texas, was a recruiting firm that specialized in placing finance, accounting, and information-technology professionals in employment positions. The controlling interest in Align was held by Brown, a Delaware limited liability company with its principal place of business in Chicago, Illinois. The controlling interest in Brown was owned by the Katzes, who were residents of the State of Utah.

Moesser was an employee of Align and a minority owner. He signed an employment agreement with Align, which contained the following provision:

Any dispute or claim arising [out of] or in any way related to this Agreement shall be settled by binding arbitration in Houston, Texas, but any dispute or controversy arising out of or interpreting this Agreement shall be settled in accordance with the laws of the State of Illinois as if this Agreement were executed and all actions were performed hereunder within the State of Illinois. All arbitration shall be conducted in accordance with the rules and regulations of the American Arbitration Association (“AAA”) . . . .

Andrea Katz signed the employment agreement on behalf of Align by signing on behalf of Brown (Align’s manager).

After a dispute arose between Moesser and Align, Moesser brought claims against Align, Brown, and the Katzes in arbitration. Brown and the Katzes argued that the AAA did “not have the authority to adjudicate any dispute as to them in this arbitration” because they were not parties to the employment agreement and had not otherwise agreed to arbitrate the claims against them. The court began by discussing the law related to arbitrability:

“[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.” *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83, 123 S. Ct. 588, 591 (2002) (internal quotations omitted). Whether a person or entity is a party to an arbitration agreement, and therefore bound by any award issued, presents a question of “arbitrability.” “Generally, only signatories to an arbitration agreement are bound by the agreement.” *Elgohary v. Herrera*, 405 S.W.3d 785, 789–90 (Tex. App.—Houston [1st Dist.] 2013, no pet.) (citing *Brown v. Pac. Life Ins. Co.*, 462 F.3d 384, 398 (5th Cir. 2006). For instance, “signing a contract in a representative capacity does not bind the agent personally to the contract.” *Elgohary*, 405 S.W.3d at 790–91.

Texas and federal law recognize, however, six theories under which a trial court could compel a non-signatory to arbitrate. Those theories include: (1) incorporation by reference, (2) assumption, (3) agency, (4) veil-piercing/alter ego, (5) estoppel, and (6) third-party beneficiary. These issues are to be resolved by the trial court before compelling a non-signatory to arbitrate.

Thus, “[w]hile non-signatories to an arbitration agreement can be bound to arbitrate under principles of contract and agency law, such issues—dealing as they do with non-signatories—are gateway ‘issues of arbitrability’ that the courts are primarily responsible for deciding—not the arbitrator.” *Elgohary*, 405 S.W.3d at 790 (quoting *Roe*, 318 S.W.3d at 515). A court should “decide that question just as it would decide any other question that the parties did not submit to arbitration, namely, independently.” *ConocoPhillips, Inc. v. Local 13-0555 United Steelworkers Int’l Union*, 741 F.3d 627, 630–31 (5th Cir. 2014).

The question of arbitrability is an issue for judicial determination unless the parties “clearly and unmistakably” agreed to submit the issue of arbitrability to the arbitrator. . . . The Supreme Court has defined a “clear willingness to arbitrate” arbitrability as “a willingness to be effectively bound by the arbitrator’s decision” on the issue of arbitrability. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 946, 115 S. Ct. 1920, 1925 (1995). Such a “willingness to be effectively bound” is not demonstrated by silence or ambiguity, or by “merely arguing the arbitrability issue to an arbitrator.” *Id.* at 945, 115 S. Ct. at 1925. Rather, clear and unmistakable evidence of an agreement to arbitrate arbitrability includes a course of conduct demonstrating assent, or an express agreement to do so. . . . Thus, in the context of the “who (primarily) should decide [the] arbitrability question,” the usual presumption in favor of arbitration, when the question concerns whether a particular dispute falls within the scope of a concededly binding arbitration agreement, is “reverse[d].” Only in cases in which the reviewing court determines that the parties “clearly and unmistakably” agreed to submit arbitrability to the arbitrator does the court defer to the arbitrator’s decision on the issue.

Moesser argued that Brown and the Katzes, in their individual capacities, “clearly and unmistakably” consented to the arbitrator’s authority to determine the jurisdictional question because the express terms of the arbitration provision in the employment agreement incorporate the AAA rules, which bestow upon the arbitrator the authority to rule on his own jurisdiction. The court of appeals disagreed:

“[S]igning a contract in a representative capacity does not bind the agent personally to the contract.” *Elgohary*, 405 S.W.3d at 791. Further, “[a]n agent in his individual capacity is a non-signatory when that agent signs an agreement with an arbitration provision in his representative capacity.” *Leshin*, 2015 WL 4554333, at \*6. . . .

Thus, Brown, Andrea, and Joel, in their individual capacities, are non-signatories to the arbitration agreement. Because Brown, Andrea, and Joel are non-signatories to the arbitration agreement, the terms of the arbitration agreement do not constitute evidence that they, in their individual capacities, agreed to arbitrate the question of arbitrability. . . .

Here, like in *First Options*, Brown and the Katzes’ objections, prior to and during the arbitration, asserting that “the AAA [did] not have the authority to adjudicate any dispute as to them in th[e] arbitration as they [were] not parties to the Employment Agreement and ha[d] not otherwise agreed to arbitrate the claims asserted,” and asking the arbitrator to dismiss them from



the arbitration on the ground that the AAA was without jurisdiction over them, expressly evidences a desire not to be bound by the arbitrator's authority.

Moesser also argued that Brown and the Katzes clearly and unmistakably agreed to submit the issue of arbitrability to the arbitrator because they not only presented argument on the merits of whether they were bound to arbitrate, but they invoked the AAA, stating: "Pursuant to AAA Rule R-7(a), 'The arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement.'" Moesser asserts that Brown and the Katzes, having represented to the arbitrator that he had the authority to determine arbitrability and asking him to do so, cannot now complain that he lacked authority to decide the issue. Once again, the court of appeals disagreed:

Again, Brown and the Katzes having "merely argu[ed] the arbitrability issue to an arbitrator" in support of their objections, "does not indicate a clear willingness" to be bound by the arbitrator's decision on arbitrability and to forego independent judicial review. That Brown and the Katzes referenced the AAA rule granting the arbitrator the authority to decide his jurisdiction and noted that the arbitrator's ruling on their objections and request for dismissal necessarily encompassed certain determinations does not constitute a course of demonstrating assent or "clear and unmistakable" evidence that they intended to be bound by the arbitrator's decision as to arbitrability. Moreover, a "willingness to be effectively bound" by the arbitrator's decision on the issue of arbitrability is not demonstrated by ambiguity.

We conclude that the question of whether Brown and the Katzes, in their individual capacities, are parties to the arbitration agreement was a matter for the trial court, and not the arbitrator. Because the trial court, and not the arbitrator, should have decided the "gateway issue" of whether Brown and the Katzes agreed to be bound by arbitration, the arbitrator exceeded his authority. We hold that the trial court erred in confirming, and not vacating, the arbitration award.

*Ambulatory Services of Puerto Rico v. Sankar Nephrology Group, LLC*, No. 4:17-CV-230-A, 2017 WL 1954932 (N.D. Tex. May 9, 2017). (Although the court issued this opinion in 2017, it is included in this year's update because it did not appear in the Westlaw database until recently.)

The determination of arbitrability of a dispute between members of an LLC was to be made by an arbitrator because the arbitration clause in the LLC agreement stated that arbitration would take place in accordance with the Commercial Arbitration Rules of The American Health Lawyers Association.

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

*Higher Perpetual Energy, LLC v. Higher Power Energy, LLC*, Civ. A. No. 4:17-CV-00414, 2018 WL 3020328 (E.D. Tex. June 18, 2018).

The court denied a motion to dismiss a claim of improper denial of access to books and records asserted against defendants Higher Power Energy, LLC ("Higher Power"), Mark Patkunas, Michael Miller, and Lance Wilkerson.

The certificate of formation of Baker Wind Farm, LLC identified Patkunas, Miller, David Tatton, and Wilkerson as its four managers and governing persons. Plaintiff Higher Perpetual Energy, LLC alleged that, as a member of Baker Wind, it was denied the right to examine the books and records of the company. Defendants moved to dismiss the claim. The court stated that pursuant to § 101.502 of the Business Organizations Code, a member of an LLC maintains the right to examine books and records as specified in § 3.151 and § 101.501. The plaintiff alleged that defendants refused to permit an examination of the books and records as prescribed by statute, and the court found that those allegations were sufficient to satisfy the pleading requirements.

The plaintiff further alleged that Higher Power committed a conversion by wrongfully exercising dominion and control over the plaintiff's interest in Baker Wind. Plaintiff alleged that "Higher Power conveyed to Higher Perpetual 'a 30% membership interest, right, and title in the Baker Project' . . . [and that such interest] is [the plaintiff's] personal property." Further, the plaintiff explained that Higher Power wrongfully exercised dominion and control over such property when it sold it without consent and without proper compensation. The court cited the elements of a conversion claim and concluded that the plaintiff sufficiently pleaded a claim for conversion.

The plaintiff also sought a declaration that “the venture between Higher Perpetual and Higher Power regarding the Baker Wind Farm Project constitute[d] a limited liability company.” The court found that the request for declaratory relief was sufficiently pleaded.

*Nerium SkinCare, Inc. v. Nerium International, LLC*, Civ. A. No. 3:16-CV-1217-B, 2017 WL 9471419 (N.D. Tex. April 5, 2017). (Although the court issued this opinion in 2017, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court denied the plaintiffs’ motion to compel a statutory records inspection.

Plaintiffs Nerium SkinCare, Inc. and Nerium Biotechnology, Inc. filed a lawsuit for breach of contract. Their amended complaint included a cause of action for statutory records inspection under § 101.502 of the Texas Business Organizations Code. That section provides that “[a] member of a limited liability company . . . on written request and for a proper purpose, may examine and copy at any reasonable time and at the member’s . . . expense” records required to be kept under Sections 3.151 and 101.501 of the code, as well as “other information regarding the business, affairs, and financial condition of the company that is reasonable for the person to examine and copy.”

The court denied the plaintiffs’ request for an order compelling the company, Nerium International, LLC, to comply with the statutory books and records request. The court observed that “Plaintiffs have pointed the Court to no cases—from this district or any other—where a federal district court has ordered a statutory books and records request when litigation was already pending regarding the same issues forming the basis of the books and records request.” According to the court, “Plaintiffs only cite a single case where even a state court allowed such a statutory records request once litigation had been initiated. However, that case—*In re Halter*—an unpublished Texas appellate court opinion, is not persuasive.”

The court also looked to Delaware cases and concluded that, “[i]n reviewing these cases, the Court finds a clear preference in the Delaware decisional law for a statutory records request to come before initiating litigation.” The court indicated that “[t]he cases appear to suggest that once a lawsuit is filed, which ‘necessarily reflects [the] view that [a plaintiff] had sufficient grounds for alleging . . . its substantive claims without the need for the assistance afforded by [a statutory inspection request], [the plaintiff] is . . . unable to tender a proper purpose for pursuing its efforts to inspect the books and records.’”

Finally, the court observed that “Plaintiffs have repeatedly acknowledged that the records they seek would also be available to them via the normal discovery process.” As the Delaware courts have noted, “[t]he availability of discovery in the Plenary Action undercuts [a plaintiff’s] alleged need to investigate mismanagement through an inspection demand.” *Bizzari v. Suburban Waste Servs., Inc.*, C.A. No. 10709-JL, 2016 WL 4540292, at \*6 (Del. Ch. Aug. 30, 2016).

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

*Nerium SkinCare, Inc. v. Nerium International, LLC*, Civ. A. No. 3:16-CV-1217-B, 2018 WL 2323243 (N.D. Tex. Mar. 26, 2018), report and recommendation adopted, 2018 WL 2323471 (N.D. Tex. May 2, 2018).

The court (via a Special Master) denied summary judgment on a claim for involuntary dissolution.

Nerium SkinCare, Inc. (“NSC”) manufactured consumer skin care products containing extract from the *Nerium oleander* plant. In early 2010, NSC was introduced to Jeff Olson, an entrepreneur with extensive multi-level marketing experience. NSC and Olson agreed to form a new company, Nerium International, Inc. (“NI”). The only two members of NI were JO Products, LLC (“JOP”), an entity controlled by Olson, which owned 70% of NI, and NSC, which owned the remaining 30% of NI. Olson was the sole manager of NI. NSC was tasked with the testing, production, and delivery of products.

After disputes arose between the parties, NSC sought summary judgment on its claim for judicial wind-up and termination of NI. NSC argued that wind-up and termination was warranted under § 11.314 of the Business Organizations Code, which provides:

A district court in the county in which the registered office or principal place of business in this state of a domestic partnership or limited liability company is located has jurisdiction to order the winding up or termination of the domestic partnership or limited liability company on application by an owner of the partnership or limited liability company if the court determines that:

- (1) the economic purpose of the entity is likely to be unreasonably frustrated;
- (2) another owner has engaged in conduct relating to the entity's business that make[s] it not reasonably practicable to carry on the business with that owner; or
- (3) it is not reasonably practicable to carry on the entity's business in conformity with its governing documents.

In the alternative, NSC argued that the court should recognize a common law cause of action to terminate a closely held company for breach of the governing documents.

The court noted that judicial dissolution, given its extreme nature, is a limited remedy that courts grant sparingly. The court then denied summary judgment on NSC's claim:

The main argument advanced by NSC to justify the drastic remedy of judicial wind-up and termination is that NI and Olson have frustrated the purpose of the company by selling products that compete with NSC products in violation of the governing documents. However, as explained earlier in this recommendation, the Company Agreement does not prohibit NI or Olson from marketing and selling non-NSC products. NSC also points to its strained relationship with Olson as grounds for dissolving the company. There is no doubt that the relationship between NSC and Olson has deteriorated over time. But section 11.314 requires more than just a disagreement between owners. It requires proof that it is no longer "reasonably practicable" for the parties to carry on business with each other or in conformity with the company agreement. Without suggesting a view of whether NSC may be entitled to an order of judicial wind-up and termination if it prevails on its claims after a trial on the merits, such relief is not proper by way of summary judgment.

#### **K. Forfeiture and Involuntary Termination**

*Platinum Air Group, LLC v. Short's Travel, Management, Inc.*, 3:10-CV-01576-P, 2010 WL 11619032 (N.D. Tex. Oct. 13, 2010) (Although the court issued this opinion in 2010, it is included in this year's update because it did not appear in the Westlaw database until recently.)

The court denied a motion to dismiss alleging that an LLC lacked the capacity to sue.

Platinum Air Group, LLC ("Platinum") filed a complaint alleging a breach-of-contract claim. The defendant filed a motion to dismiss on the basis that Platinum had forfeited its existence and lacked the capacity to sue. The court noted that, under Texas law, "if a corporation's privileges are forfeited pursuant to subchapter F of chapter 171 of the Texas Tax Code, the corporation shall be denied the right to sue or defend." However, "[i]f a corporation can show that it has returned to active status before the lawsuit has been dismissed then the corporation will maintain the capacity to sue regardless of whether it lacked that capacity at the time of the initial [f]iling."

Platinum submitted evidence to the court that it had returned to active status prior to dismissal of the lawsuit. As a result, the court denied the defendant's motion to dismiss as well as its request for attorney's fees.

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

*Rahlek, Ltd. v. Wells*, 2019 WL 2220600, \_\_\_ S.W.3d \_\_\_ (Tex. App.—Eastland 2019, no pet. h.).

The court held that it was not necessary to rely on veil-piercing principles to argue that an individual's letter signed in a representative capacity for an LLC waived rights of the individual, but the evidence did not conclusively establish an intent to relinquish the rights, and the trial court did not err in denying the affirmative defense of waiver.

In a dispute regarding the conveyance of mineral and royalty interests, certain claimants to the interests (the "Campbell Children") argued that another claimant, Ricky Grubbs, intentionally engaged in conduct inconsistent with claiming a right to recover royalties by sending letters to the Campbell Children acknowledging that they owned a royalty interest in land at issue. Grubbs argued that he did not waive his right to recover royalties because the letters were sent on behalf of an LLC that was the operator of the tract and of which he was the sole owner and manager. The court stated that Grubbs appeared to argue that the Campbell Children were required to plead and

prove veil piercing to prevail on their affirmative defense of waiver since he engaged in the conduct in a representative capacity.

The court of appeals stated that Grubbs's reliance on veil piercing was misplaced in that such principles are typically used to impose a corporation's legal obligation on a shareholder, director, or officer. The court recognized that corporate veil-piercing policies also apply to LLCs; however, the court said there was no need for the Campbell Children to plead veil piercing or allege alter ego because the Campbell Children did not seek to impose individual liability on Grubbs.

The court next rejected Grubbs's argument that he could not have waived his individual rights to royalties in a letter signed by him in a representative capacity. "The fact that Grubbs directed the letters to be sent in his capacity as an agent (rather than in his individual capacity) does not strip him of the knowledge he possessed when he did so—that the Campbell Children were receiving royalties from and possessed a royalty interest in the Grubbs 'A' Lease Tract." Thus, the court concluded that "with the requisite knowledge and intentional acts, Grubbs could have waived his personal right to recover royalties, in part, by sending the letters to the Campbell Children." Nevertheless, viewing the evidence in the light most favorable to the verdict, the court concluded it was not clear from Grubbs's conduct that he intended to relinquish his right to recover royalties from the Campbell Children.

*Mason v. Mason*, No. 03-17-00546-CV, 2019 WL 1967166 (Tex. App.—Austin May 3, 2019, no pet. h.) (mem. op.).

In the context of a divorce action in which the court of appeals discussed the wife's claim for reimbursement to the community estate based on alleged benefit to the husband's separate-property membership interest in a single-member LLC that received loans from the community estate, the court recognized the nature of the LLC as a separate legal entity and the inability of a court to divide assets of the LLC in a divorce, but the court commented in a footnote as follows: "In exceptional circumstances, the principles of alter ego and piercing the corporate veil have been applied to divorce cases under what could be termed 'reverse piercing.' *Lifshutz v. Lifshutz*, 61 S.W.3d 511, 516 (Tex. App.—San Antonio 2001, pet. denied). When the corporate veil is pierced in a divorce case, the trial court may characterize assets that otherwise belong to the corporation as belonging to the community. *Id.* Although a claim of alter ego is not a per se claim for reimbursement, it may in some instances . . . have the same effect."

*Bates Energy Oil & Gas v. Complete Oilfield Services*, 361 F. Supp. 3d 633 (W.D. Tex. 2019).

The court dismissed (with leave to amend) veil-piercing claims against the managing member of an LLC because the allegations did not demonstrate a basis for finding that the alleged fraud was for the direct personal benefit of the managing member.

In a dispute arising out of the sale of frac sand by Bates Energy Oil and Gas ("Bates Energy") to Complete Oilfield Services ("COFS"), COFS asserted claims against Equity Liaison Company, LLC ("ELC") and Dewayne Naumann—ELC's managing member—for fraud and other torts based on actions taken by Naumann in connection with an escrow agreement among ELC (as escrow agent), COFS, and Bates Energy. COFS alleged claims against Naumann based on individual direct liability as well as vicarious liability under a veil-piercing theory. The tort claims related to or arose from ELC's contractual obligations under the escrow agreement, and COFS did not dispute that Tex. Bus. Orgs. Code § 21.223 (applicable to LLCs by virtue of § 101.002) required COFS to allege that Naumann caused ELC to be used for the purpose of perpetrating and did perpetrate an actual fraud on COFS primarily for the direct personal benefit of Naumann in order to impose vicarious liability on Naumann based on veil piercing. Naumann also argued that § 21.223 applied to the claims for direct liability because the alleged torts were committed in his representative capacity for ELC. After a lengthy analysis of §§ 21.223 and 21.224 (and the predecessor provisions in Article 2.21 of the Texas Business Corporation Act) and the case law interpreting the statutory provisions, the court concluded that § 21.223 did not apply to the claims for direct liability.

With respect to the adequacy of COFS's allegations of vicarious liability against Naumann based on veil piercing, the court stated:

The Court concludes that COFS has not sufficiently pled facts demonstrating that the fraud was primarily for Naumann's direct personal benefit. The allegations all refer to "ELC/Naumann" as one, and they state that unauthorized disbursements were transferred to "ELC" or placed in "ELC/Naumann's personal checking account." While "primarily for the direct personal benefit"

of the individual is not defined, most cases finding the requirement to have been met had evidence showing that “funds derived from the corporations’ allegedly fraudulent conduct were pocketed by or diverted to the individual defendant.” *Hong*, 551 S.W.3d at 885 (listing cases). When the funds were used for the corporation’s benefit, that has been held insufficient, even where it indirectly benefits the corporate officers and agents because the corporation is “able to live another day due to its ability to satisfy some demands” or because their ownership interest retains its value, and this appears true even where the individual is the sole shareholder and where corporate formalities are disregarded. *Morgan v. Fuller*, No. 07-15-00314, 2016 WL 2766106, at \*2-3 (Tex. App.—Amarillo 2016, no pet.); *Transpecos Banks v. Strobach*, 487 S.W.3d 722 (Tex. App.—El Paso 2016, no pet.). Because the allegations either state that money was given to ELC or to ELC/Naumann (TAC ¶ 70, 71, 75, 83) or were placed into “ELC/Naumann’s personal checking account” or “ELC/Naumann’s high-interest money market account,” the pleadings fail to demonstrate a basis for finding that the fraud was primarily for Naumann’s direct personal benefit.

***Stover v. ADM Milling Co.***, No. 05-17-00778-CV, 2018 WL 6818561 (Tex. App.—Dallas Dec. 28, 2018, no pet. h.) (mem. op.).

The court of appeals held that the evidence was sufficient to support the finding that the members of an LLC used the LLC to perpetrate an actual fraud for their direct personal benefit for purposes of imposing liability on the members for the LLC’s breach of contract, fraud, and statutory fraud under the alternative veil-piercing theories of sham to perpetrate a fraud or alter ego.

Two individuals, Stover and Harkey, formed an LLC for the purpose of purchasing real property. After the LLC entered into a contract to purchase the property for a purchase price of \$1.6 million, the LLC failed to close on the scheduled closing date. The LLC gave several excuses for the delay, including difficulty in obtaining financing and several other complications. Meanwhile, the LLC’s lawyer encouraged his son (who was interested in investing in the property under contract to the LLC) to enter into negotiations with Stover and Harkey for the purchase of the LLC for \$1.8 million (understood by the parties to be a \$200,000 premium for Stover and Harkey since the purchase price for the property was \$1.6 million). Stover and Harkey negotiated with the lawyer’s son over a period of several months but did not disclose the negotiations to the owner of the property. Stover and Harkey never reached an agreement for the sale of their LLC to the lawyer’s son, and eventually the LLC’s lawyer proposed to the owner of the property that the LLC pay an additional earnest-money payment for an extension of the closing date. After the owner of the property agreed to the extension, the LLC did not make the additional payment for the extension and terminated the purchase contract. The owner of the property sued the LLC, Stover, Harkey, the LLC’s lawyer, and the lawyer’s son. The plaintiff obtained a judgment based on favorable jury findings on various claims against all the parties. Stover and Harkey challenged the judgment against them on several grounds.

On appeal, the court first held that Stover and Harkey did not have standing to challenge the findings of liability on the claims asserted against the LLC. In the court below, the LLC was held liable for breach of contract and fraud, and Stover and Harkey were held liable for the LLC’s fraud and breach of contract based on veil-piercing principles. The LLC did not appeal its liability, and the court reasoned that Stover and Harkey only had standing to appeal the findings relating to their liability under veil-piercing principles.

Stover and Harkey challenged the sufficiency of the evidence that supported the jury’s findings imposing on them personal liability for the LLC’s breach of contract and fraud under the alternative theories of sham to perpetrate a fraud and alter ego, arguing that the evidence did not show they used the LLC to perpetrate an actual fraud for their direct personal benefit as required by Tex Bus. Orgs. Code § 21.223(b). The court explained that “actual fraud” for purposes of piercing the corporate veil is not the equivalent of the tort of fraud; rather, “actual fraud” in the veil-piercing context involves “dishonesty of purpose or intent to deceive.” The court also explained that the phrase “primarily for the direct personal benefit” is not defined by Section 21.223, but courts have concluded that this requirement has been met when funds derived from a corporation’s fraudulent conduct have been “pocketed by or diverted to” the individual defendant.

After concluding that Stover and Harkey failed to preserve and adequately brief their challenge regarding their use of the LLC to perpetrate an actual fraud, the appellate court turned to their argument regarding the sufficiency of the evidence to show that any fraud perpetrated by the LLC was for their direct personal benefit. The court concluded that the evidence supported this requirement based on text messages and emails relating to the attempts by Stover and Harkey to sell their LLC interests for a \$200,000 premium. In this regard, the court

concluded that “the evidence is legally sufficient to support the jury’s finding that the corporate veil should be pierced and Stover and Harkey should be individually liable for [the LLC’s] breach of contract, fraud, and statutory fraud because the evidence shows that \$200,000 were not going to be used for [the LLC’s] financial obligations, but were to be diverted to Stover and Harkey.”

***BSG Clearing Solutions North America, LLC v. Durham Technology, LLC***, Civil Action No. SA-17-CV-1097-XR, 2018 WL 6219812 (W.D. Tex. Nov. 20, 2018).

The court granted a motion for no-answer default judgment against an individual and six LLCs and five corporations controlled and operated by the individual defendant. The allegations established that the LLCs and corporations were liable on contracts with the plaintiffs, and the allegations were sufficient to show that the individual was the alter ego of the entities and used the entities to achieve an inequitable result such that it would be unjust to hold only the entity defendants liable.

The plaintiffs sued six LLCs and five corporations for breach of services agreements entered into with these entities. The plaintiffs also sued Landeen, an individual who allegedly controlled and operated the entity defendants, on the basis that she was liable as the alter ego of the entities. None of the defendants answered, and the plaintiffs moved for default judgment.

After concluding that the allegations supported a default judgment against the entities for breach of contract, the court proceeded to address the sufficiency of the plaintiffs’ allegations to establish liability of the individual defendant. The court listed the six situations under which a court may disregard the corporate form under Texas law and focused its discussion on the situation commonly referred to as “alter ego,” which “applies when there is such unity between corporation and individual that the separateness of the corporation has ceased and holding only the corporation liable would result in injustice.” The court listed factors that may be considered in the analysis and pointed out that parties are not liable for a corporation’s liabilities merely because they are part of a “single business enterprise.” The court characterized the “touchstone” of the alter-ego analysis as “whether ‘holding only the corporation liable would result in injustice.’”

The plaintiffs alleged that Landeen controlled and operated all the entity defendants and misrepresented and concealed facts related to the entities’ adherence to corporate formalities, the propriety of charges incurred, and the entities’ intent to indemnify the plaintiffs under the contracts. The plaintiffs further alleged on information and belief that Landeen organized and operated each entity as a mere tool or business conduit and used the corporate form as a sham to perpetuate fraud. The court concluded that “[a]s a whole these allegations if taken as true, show it would be unjust to hold only the corporate-entity Defendants liable, as Landeen used the corporate form to achieve an inequitable result.” Thus, the court granted the motion for default judgment holding Landeen jointly and severally liable with the entity defendants for the breaches of contract.

***MCR Oil Tools, LLC v. SPEX Offshore, Ltd.***, Civ. A. No. 3:18-cv-00731-M, 2018 WL 4362695 (N.D. Tex. Sept. 13, 2018).

“The Court notes that the requested business and organizational documents sought by MCR are relevant and discoverable under Texas alter ego law. Presumably, Texas law will govern whether the corporate veil of SPEX Group, a Texas limited liability company, will be pierced. *See* Tex. Bus. Orgs. Code § 1.104; *see also* *Alberto v. Diversified Grp., Inc.*, 55 F.3d 201, 204 (5th Cir. 1995); *Davaco, Inc. v. AZ3, Inc.*, No. 3:07-CV-803, 2008 WL 2243382, at \*1 (N.D. Tex. May 30, 2008) (“[A] choice of law provision in a contract does not alter the rule that the law of the state of incorporation governs the alter ego analysis.”). Under Texas law, factors demonstrating an alter ego relationship include ‘the degree to which corporate formalities have been followed and corporate and individual property have been kept separately, the amount of financial interest, ownership and control the individual maintains over the corporation, and whether the corporation has been used for personal purposes.’ *Castleberry v. Branscum*, 721 S.W.2d 270, 272 (Tex. 1986). The business and corporate documents that MCR seeks from Defendants in Request for Production No. 3 are certainly relevant to establishing these factors.”

***Ball Up, LLC v. Strategic Partners Corp.***, No. 02-17-00197-CV, No. 02-17-00198-CV, 2018 WL 3673044 (Tex. App.—Fort Worth Aug. 2, 2018, no pet.) (mem. op.).

The court of appeals affirmed the trial court’s orders granting the special appearances of an individual, a Delaware LLC, and a Delaware limited partnership, and reversed the trial court’s denial of a Delaware corporation’s special appearance.

Ball Up, LLC (Texas LLC) sued various defendants for misrepresentation and conspiracy: Mike Singer individually (CEO of Strategic Distribution, LP); Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC. These three entity defendants made general appearances. Ball Up also named as defendants Strategic Partners Corp. (Delaware corporation); PG-ACP Holdings, L.P. (Delaware limited partnership); PG-ACP Holdings GP, LLC (Delaware LLC); and Strategic Partners Acquisition Corp. (Delaware corporation) (“SPAC”). After a hearing, the trial court signed orders and amended orders sustaining special appearances filed by Singer individually and the Appellee Entities—Strategic Partners Corp.; PG-ACP Holdings, L.P.; and PG-ACP Holdings GP, LLC. The trial court denied the special appearance filed by SPAC. The court of appeals referred to the generally appearing defendants, the Appellee Entities, and SPAC collectively as the “SP Companies.”

On appeal, Ball Up challenged the trial court’s orders sustaining the special appearances of Singer and the Appellee Entities. SPAC similarly challenged the denial of its special appearance. Ball Up’s challenge was based in part on an argument that the Texas contacts of some of the generally appearing defendants could be imputed to Singer, the Appellee Entities, and SPAC on piercing grounds. In discussing the law of personal jurisdiction based on a piercing theory, the court of appeals observed:

Concerning allegations of personal jurisdiction over a defendant based on the alter-ego theory, personal jurisdiction may exist over a nonresident defendant if the relationship between the foreign corporation and its parent corporation that does business in Texas is one that would allow the court to impute the parent corporation’s “doing business” to the subsidiary. *BMC Software Belg., N.V.*, 83 S.W.3d at 798–99. The rationale for exercising alter-ego personal jurisdiction is that “the parent corporation exerts such domination and control over its subsidiary ‘that they do not in reality constitute separate and distinct corporate entities but are one and the same corporation for purposes of jurisdiction.’” *Id.* (quoting *Hargrave v. Fibreboard Corp.*, 710 F.2d 1154, 1159 (5th Cir. 1983)). The party seeking to ascribe one corporation’s actions to another by disregarding their distinct corporate entities must prove this allegation because Texas law presumes that two separate corporations are indeed distinct entities. *Id.*

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 and that the degree of control the parent exercises is 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 proof required of a party seeking to fuse a parent company and a subsidiary company for jurisdictional veil-piercing purposes is different and more strenuous than the proof required of a party seeking to fuse a parent and a subsidiary company for substantive veil-piercing purposes. . . .

Because Texas law presumes that two separate corporations are distinct entities, Ball Up, as the party seeking to ascribe the actions of some of the SP Companies to other of the SP Companies for jurisdictional purposes by piercing the corporate veil, bore the burden of proving an alter-ego relationship. Absent proof by Ball Up establishing a factual basis for some legal theory, such as alter-ego or single-business enterprise, to attain corporate veil piercing that will support the aggregation of acts or contacts by separate legal entities, they will not be aggregated. That is, Ball Up’s pleadings and briefing relating to acts performed by and contacts with the SP Companies (assuming the facts pleaded such contacts and acts occurred in Texas) is nonetheless not sufficient to establish general-jurisdiction minimum contacts or specific committed-a-tort-in-whole-or-in-part-in-Texas jurisdiction unless the acts and contacts Ball Up has attributed to the SP Companies are attributable to one or more of the Appellee Entities, to SPAC, or to Singer under an alter-ego/veil-piercing theory.

The court of appeals ultimately concluded that Ball Up failed to meet its burden of establishing its piercing allegations for jurisdictional purposes:

On appeal, Ball Up does not focus on the purported alter-ego relationship existing between any particular SP Companies or Singer. Instead, Ball Up argues that personal jurisdiction exists under the alter-ego/veil-piercing theory because the SP Companies “cannot prove which

company(ies) made the decisions on the Ball Up project, they cannot prove which company(ies) did not make the decisions on the Ball Up Project” and that, therefore, “none of these entities can negate Ball Up’s allegations that they were involved in the project.” But Ball Up—not the Appellee Entities, SPAC, or Singer—had the burden of pleading and proving an alter-ego/veil-piercing theory in order to attribute contacts with the forum by one defendant to another defendant or to attribute jurisdictional acts by one defendant to another defendant.

Ball Up had the burden to overcome the presumption that two separate business entities are distinct by proving its alter-ego/veil-piercing allegation. To fuse all of the SP Companies for jurisdictional purposes—that is, to make the acts or contacts of the generally-appearing defendants Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC or of other specially-appearing defendants constitute acts or contacts by the Appellee Entities, SPAC, or Singer—Ball Up was required to establish that the Appellee Entities, SPAC, or Singer exercised a degree of control over Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC that is “greater than that normally associated with common ownership and directorship”; the evidence must show that the Appellee Entities, SPAC, Singer, and the generally-appearing defendants or some combination of these ceased to be separate.

The following factors have been identified as important to determining whether a subsidiary is separate and distinct from its parent corporation for personal jurisdiction purposes: (1) the amount of the subsidiary’s stock owned by the parent corporation, (2) the existence of separate headquarters, (3) the observance of corporate formalities, and (4) the degree of the parent’s control over the general policy and administration of the subsidiary. The types of evidence a court will consider as proof of alter ego—when a person is alleged to be the alter ego of a corporation but also applicable in allegations of entity-to-entity alter ego—include: (1) the payment of alleged corporate debt with personal checks or other commingling of funds; (2) representations that the individual will financially back the corporation; (3) the diversion of company profits to the individual for his personal use; (4) inadequate capitalization; and (5) other failure to keep corporate and personal assets separate.

Ball Up did not offer evidence of financial commingling of funds between any combination of the SP Companies and Singer, the payment of one of the SP Companies’ debt by another or by Singer, the diversion of profits from one SP Company to another or to Singer, the failure to keep separate accounting records or corporate books, a lack of separate legal formation, or other evidence that would establish that the Appellee Entities, SPAC, or Singer exercised a degree of control over Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC that is greater than that normally associated with common ownership and directorship so that the Appellee Entities, SPAC, and the generally-appearing defendants ceased to be separate entities.

The evidence Ball Up did produce with regard to SPAC consisted of two spreadsheets containing SPAC’s name that were provided to Ball Up and that detailed the Ball Up Apparel Project’s expenses. Ball Up argues that these spreadsheets coupled with the alleged failure of the SP Companies to maintain separate and distinct corporate identities is sufficient to support the trial court’s denial of SPAC’s special appearance. We cannot agree. Even if SPAC created the spreadsheet for the project’s current expenses, the two spreadsheets simply represent a calculation of expenses and do not establish any amounts billed by SPAC or work performed by SPAC. Thus, the spreadsheets are insufficient to support a showing that SPAC has the minimum contacts necessary to demonstrate that the trial court has personal jurisdiction over SPAC.

The evidence Ball Up did produce with regard to the Appellee Entities consisted of excerpts from [Robert] Pierpoint’s deposition [an officer of various SP Companies] establishing that the composition of the board of directors of each of the SP Companies was the same or substantially the same; that Padraic McConville worked for Partners Group; that Partners Group was a private equity partner that sat on the board of directors for PG-ACP Holdings, GP; and that McConville put Ball Up proposal numbers together for the PG-ACP Holdings, GP’s board of directors. Ball Up’s evidence and contentions, however, do not rise to the required level of control and domination by one or more of the SP Companies over one or more of the other SP Companies necessary to meet Ball Up’s burden of proving that the SP Companies ceased to be separate entities



and are one and the same for jurisdictional purposes. [Ball Up does not specifically identify which of the generally-appearing defendants, the Appellee Entities, or SPAC are purportedly fused for jurisdictional purposes; Ball Up alleges all of them were intertwined and acted jointly.]

Ball Up’s alter-ego/veil-piercing jurisdictional evidence at most shows some common ownership between the SP Companies and some common and overlapping boards of directors; this type of evidence does not establish alter ego for jurisdictional purposes. [If Ball Up had met its burden of proving alter ego, no evidence exists that piercing the corporate veil of any particular entity or entities for purposes of personal jurisdiction is necessary to prevent fraud or injustice.]

Because Ball Up failed to assert or to offer proof of acts by the Appellee Entities, SPAC, and Singer in furtherance of Ball Up’s tort claims against them and also failed to meet its burden of proving its alter-ego/veil-piercing jurisdictional theory concerning the Appellee Entities, SPAC, and Singer, the trial court properly sustained the Appellee Entities’ and Singer’s special appearances and erred by denying SPAC’s special appearance.

The court also observed: “In addition to factually negating personal jurisdiction, Singer’s affidavit and special-appearance evidence legally negated personal jurisdiction; Singer established that at all times in any dealings with Ball Up he was acting in his corporate capacity on behalf of generally-appearing Strategic Distribution. Thus, even if Singer had contacts with Texas or performed acts in Texas—which he directly denied in his affidavit—personal jurisdiction over him could not be predicated on jurisdiction over Strategic Distribution unless Strategic Distribution is the alter ego of Singer.”

*Skrastina v. Breckinridge-Taylor Design, LLC*, No. 05-17-00796-CV, 2018 WL 3078689 (Tex. App.—Dallas June 20, 2018, no pet.) (mem. op.).

“Skrastina alleged Woolsey and Thomas [members of BTD, an LLC] were individually liable for BTD’s acts under principles of veil piercing. Although recognizing that under section 101.114 of the business organizations code, members of a limited liability company are not personally liable for the company’s debts, obligations, or liabilities, Skrastina alleged those statutory protections ‘give way’ when it can be shown the limited liability company was used for the purpose of perpetrating a fraud for the member’s personal benefit and that there was a ‘dishonesty of purpose or intent to deceive.’ Woolsey and Taylor moved for summary judgment on [the] grounds [that] there was no evidence of any underlying cause of action, that they were BTD’s alter ego, or of dishonesty of purpose or intent to deceive. . . .

Veil-piercing doctrines are not substantive causes of action. Rather, they are a means of imposing on an individual a corporation’s liability for an underlying cause of action. ‘Without an underlying cause of action creating corporate liability, evidence of an abuse of the corporate form is immaterial.’ We have concluded the trial court did not err by granting summary judgment in favor of BTD on all of Skrastina’s claims. Because Skrastina failed to produce evidence supporting the underlying causes of action, the trial court also properly granted summary judgment for Woolsey and Taylor on Skrastina’s veil-piercing theories.”

*Servicios Misiones S.A. de C.V. v. B R Crane & Equipment, LLC*, Civil Action No. H-17-3347, 2018 WL 2864286 (S.D. Tex. June 11, 2018).

The court granted the motion of an LLC member to set aside a default judgment against the member in a suit against the LLC and the member. The member argued that he was not liable for the LLC’s breach of contract because he acted solely as an agent of the LLC, citing Tex. Bus. Orgs. Code § 101.114. Further, the member argued that personal liability would only be appropriate if he used the LLC to perpetrate an actual fraud on the obligee for the member’s direct personal benefit, which he contended he did not. Thus, the member set forth the defense on which he intended to rely and showed the possibility that the outcome after a trial would be contrary to the result achieved by the default. The court rejected the plaintiff’s argument that setting aside the default judgment would prejudice the plaintiff’s ability to collect damages because the LLC no longer did business and could not satisfy the judgment. The court said this would be true whether the plaintiff sought to enforce the default judgment or any other judgment, and the plaintiff did not explain how the LLC’s inability to pay damages implicated a loss of evidence, difficulties in discovery, or greater opportunities for fraud or collusion.

*U.S. KingKing, LLC v. Precision Energy Services, Inc.*, 555 S.W.3d 200 (Tex. App.—Houston [1st Dist.] 2018, no pet.).

The court of appeals reversed the trial court’s summary judgment ruling that two LLCs were alter egos of each other.

Amerril was a limited liability company involved in oil and gas exploration. KingKing, also a limited liability company, was the United States branch of a Chinese corporation and was one of the members of Amerril. Weatherford entities provided services to Amerril and Amerril failed to pay multiple invoices. Weatherford asserted breach-of-contract claims against Amerril and also alleged that KingKing was liable for Amerril’s contractual obligations because Amerril was an alter ego of KingKing. Weatherford alleged that KingKing used Amerril to perpetrate an actual fraud on Weatherford by “purposefully creating Amerril as a shell entity with no control of any funds with which to pay Weatherford and by failing to disclose the extent of KingKing’s control at the time of contracting and throughout the course of this lawsuit.” Weatherford moved for summary judgment on its alter ego claim and the trial court granted the motion.

On appeal, KingKing contended that the trial court erred in granting summary judgment against it because Weatherford failed to conclusively establish that Amerril was KingKing’s alter ego and that KingKing used Amerril to perpetrate an actual fraud on Weatherford for KingKing’s direct personal benefit. The court began by discussing at length the law related to piercing the veil:

Business Organizations Code section 21.223 provides:

(a) A holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted, or any affiliate of such a holder, owner, or subscriber or of the corporation, may not be held liable to the corporation or its obligees with respect to:

....

(2) any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder, beneficial owner, subscriber, or affiliate is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory;

....

(b) Subsection (a)(2) does not prevent or limit the liability of a holder, beneficial owner, subscriber, or affiliate if the obligee demonstrates that the holder, beneficial owner, subscriber, or affiliate caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, beneficial owner, subscriber, or affiliate.

TEX. BUS. ORGS. CODE ANN. § 21.223 (West 2012). The principles applicable to piercing the corporate veil apply equally to limited liability companies. *McCarthy v. Wani Venture, A.S.*, 251 S.W.3d 573, 590–91 (Tex. App.—Houston [1st Dist.] 2007, pet. denied); see TEX. BUS. ORGS. CODE ANN. § 101.002(a) (West 2012) (providing that section 21.223 applies to limited liability companies and their members). Although “actual fraud” is not statutorily defined, courts have construed that term, for purposes of piercing the corporate veil, as “involv[ing] dishonesty of purpose or intent to deceive.” *Tryco Enters., Inc. v. Robinson*, 390 S.W.3d 497, 508 (Tex. App.—Houston [1st Dist.] 2012, pet. dism’d); see *TecLogistics, Inc. v. Dresser–Rand Grp., Inc.*, 527 S.W.3d 589, 598 (Tex. App.—Houston [14th Dist.] 2017, no pet.).

Generally, a corporation is a separate legal entity that insulates its owners or shareholders from personal liability for corporate obligations. Alter ego applies “when there is such unity between corporation and individual that the separateness of the corporation has ceased and holding only the corporation liable would result in injustice.” *Tryco Enters.*, 390 S.W.3d at 508 (quoting *Castleberry v. Branscum*, 721 S.W.2d 270, 272 (Tex. 1986)); see *Wilson v. Davis*, 305 S.W.3d 57, 69–70 (Tex. App.—Houston [1st Dist.] 2009, no pet.) (stating that rationale behind alter-ego doctrine is that “if the shareholders themselves disregard the separation of the corporate enterprise, the law will also disregard it so far as necessary to protect individual and corporate creditors”) (quoting *Castleberry*, 721 S.W.2d at 272). Alter ego is determined from the “total dealings” of the corporation and the individual owner, including the degree to which corporate and individual property have been kept separate, the amount of financial interest, ownership, and control the

individual maintains over the corporation, and whether the corporation has been used for personal purposes. *Tryco Enters.*, 390 S.W.3d at 508; *see also Endsley Elec., Inc. v. Altech, Inc.*, 378 S.W.3d 15, 23 & n.7 (Tex. App.—Texarkana 2012, no pet.) (stating that courts consider “inadequate capitalization” in disregarding corporate fiction, but this factor is not sufficient, standing alone, to pierce corporate veil).

Parties are not, however, jointly liable for a corporation’s obligations merely because they were part of a “single business enterprise,” that is, “merely because of centralized control, mutual purposes, and shared finances.” *Tryco Enters.*, 390 S.W.3d at 508 (quoting *SSP Partners v. Gladstrong Invs. (USA) Corp.*, 275 S.W.3d 444, 455 (Tex. 2008) ). Instead, there must also be evidence of the kinds of abuse that the corporate structure “should not shield,” such as “fraud, evasion of existing obligations, circumvention of statutes, monopolization, criminal conduct, and the like.” *SSP Partners*, 275 S.W.3d at 455.

Disregarding the corporate structure involves two considerations: (1) the relationship between the entities, and (2) whether the entities’ use of limited liability was illegitimate. Thus, to pierce the corporate veil and impose liability under an alter-ego theory, the plaintiff must demonstrate (1) that the entity on which it seeks to impose liability is the alter ego of the debtor, and (2) that the corporate fiction was used for an illegitimate purpose, that is, to perpetrate an actual fraud on the plaintiff for the defendant’s direct personal benefit. *Tryco Enters.*, 390 S.W.3d at 508; *see* TEX. BUS. ORGS. CODE ANN. § 21.223(b); *Metroplex Mailing Servs., LLC v. RR Donnelley & Sons Co.*, 410 S.W.3d 889, 896–97 (Tex. App.—Dallas 2013, no pet.) (“Evidence that a company was used as an alter ego does not, by itself create an issue regarding whether it was used to commit an actual fraud on the plaintiff for the defendant's personal benefit.”). “Generally, alter ego will not apply to disregard the corporate form absent exceptional circumstances.” *Nugent v. Estate of Ellickson*, 543 S.W.3d 243, 265 (Tex. App.—Houston [14th Dist.] 2018, no pet. h.).

The court of appeals then turned to an analysis of whether Weatherford conclusively established that Amerril was the alter ego of KingKing. It noted that “[i]n determining whether the first consideration in piercing the corporate veil has been satisfied—whether the company and the owner of the company are alter egos—we assess the relationship between the entities using such factors as: (1) whether the entities shared a common business name, common offices, common employees, or centralized accounting; (2) whether one entity paid the wages of the other entity’s employees; (3) whether one entity’s employees rendered services on behalf of the other entity; (4) whether one entity made undocumented transfers of funds to the other entity; and (5) whether the allocation of profits and losses between the entities is unclear.” The court of appeals further noted that “courts may also consider, as proof of alter ego: (1) the payment of alleged corporate debts with personal checks or other commingling of funds; (2) representations that the individual will financially back the corporation; (3) the diversion of company profits to the individual for his personal use; (4) inadequate capitalization; and (5) other failures to keep corporate and personal assets separate.” The court then reviewed Weatherford’s evidence and ultimately concluded that Weatherford did not meet its summary judgment burden to establish that Amerril was the alter ego of KingKing:

Uncontroverted evidence, however, is not necessarily conclusive evidence. Weatherford presented evidence that KingKing and Amerril share officers—Ping He and Windsor Wen—and that KingKing controls Amerril’s finances. But as the Texas Supreme Court stated in *SSP Partners*, the “[c]reation of affiliated corporations to limit liability while pursuing common goals lies firmly within the law and is commonplace,” and courts have “never held corporations liable for each other’s obligations merely because of centralized control, mutual purposes, and shared finances.” *See* 275 S.W.3d at 455.

Amerril and KingKing do not share a common business name. Although Weatherford presented evidence that Amerril and KingKing share the same mailing address, [Robert] Hadlow [KingKing’s corporate representative and the interim chief financial officer of Amerril] testified that the companies have offices in different suites but receive their mail at the same suite for convenience. No evidence in the record reflected whether Amerril or KingKing paid the wages of employees of the other entity. Although Weatherford argued that Hadlow testified as KingKing’s corporate representative despite being Amerril’s interim chief financial officer and that Hadlow

helped prepare KingKing's tax returns, Hadlow's testimony was that he had been hired by Amerril to "review the transactions and how they were booked before," and that he has "been involved in making any corrections that needed to be made from 2012 forward." Weatherford presented no evidence that any other employee of Amerril, aside from Hadlow, performs tasks or renders services for KingKing, and thus the record does not demonstrate that "employees of Amerril routinely handle the duties of US KingKing," as Weatherford contends.

The record also contains no evidence of "undocumented transfers of funds" between the entities. Hadlow testified that KingKing "contributed" oil and gas properties, including the Well, to Amerril and that Amerril did not pay consideration to KingKing, but Hadlow also testified Amerril transitioned from merely being the operator for KingKing's properties to owning and operating them. Moreover, Weatherford presented no evidence that these transfers were "undocumented" or that the entities "routinely swapped assets" or made undocumented loans to each other. Weatherford also did not present evidence that KingKing used funds that Amerril collected, such as revenue from the Well, for KingKing's own purposes unrelated to Amerril.

....  
"Evidence is conclusive only if reasonable people could not differ in their conclusions, a matter that depends on the facts of each case." *City of Keller*, 168 S.W.3d at 816. Weatherford presented some evidence that supports an alter ego finding. However, considering the record and the applicable law, Weatherford has not established, as a matter of law, that "there is such unity between [Amerril] and [KingKing] that the separateness of the corporation has ceased and holding only the corporation liable would result in injustice." *See Tryco Enters.*, 390 S.W.3d at 508. We hold that Weatherford has not conclusively established that Amerril was the alter ego of KingKing, as it was required to do to meet its summary judgment burden.

The court also concluded that Weatherford did not conclusively establish that KingKing used Amerril to perpetrate an actual fraud on Weatherford for KingKing's direct personal benefit:

Weatherford presented no evidence that individuals at Amerril or KingKing knew that this balance sheet was inaccurate at the time it was purportedly submitted to Weatherford or at any time before Hadlow discovered the error. Weatherford presented no evidence that Amerril knowingly submitted a false and inaccurate balance statement of its member and parent company in order to receive credit from Weatherford for itself. And Weatherford presented no evidence that Amerril and KingKing worked in concert to deliberately deceive Weatherford into extending credit to a company that was not creditworthy and could not pay its bills. At most, Weatherford's evidence establishes that, at some point, it received a balance sheet of KingKing that contained several overstated values. No evidence, however, establishes when Weatherford received this document, whether it relied upon this document in extending credit to Amerril, or whether Amerril knowingly submitted inaccurate financial information to obtain credit. Weatherford also presented no evidence that Amerril was insolvent or could not pay a judgment against it. Instead, the evidence reflected that KingKing had transferred oil and gas assets, including the Well, to Amerril, rather than transferring assets away from Amerril.

Based on this record, we conclude that Weatherford has not established, as a matter of law, that Amerril and KingKing acted with "dishonesty of purpose or intent to deceive." *See Tryco Enters.*, 390 S.W.3d at 508. Weatherford also has not conclusively established that Amerril's and KingKing's use of limited liability was "illegitimate" or that the companies used the corporate structure to shield abuse such as "fraud, evasion of existing obligations, circumvention of statutes, monopolization, criminal conduct, and the like." *See SSP Partners*, 275 S.W.3d at 455. Because we conclude that Weatherford has not established that KingKing caused Amerril "to be used for the purpose of perpetrating and did perpetrate an actual fraud" on Weatherford primarily for KingKing's direct personal benefit, we hold that the trial court erred in ruling that KingKing was jointly and severally liable for Amerril's contractual obligations to Weatherford.

***Saltworks Ventures, Inc. v. Residences at the Spoke, LLC***, No. 03-16-00711-CV, 2018 WL 2248274 (Tex. App.—Austin May 17, 2018, no pet.) (mem. op.).

An entity related to an LLC landlord was entitled to judgment as a matter of law on the tenant’s claim that the related entity should be held liable with the landlord because “Texas law imposes contract liability on a corporation’s affiliate only if that affiliate ‘expressly assume[s] liability’ or ‘cause[s] the corporation to be used for the purpose of perpetrating . . . an actual fraud . . . .’ Tex. Bus. Orgs. Code §§ 21.223–.225” and “[l]imited-liability companies . . . are subject to the same standard. Id. § 101.002.” The tenant had invoked a number of common-law doctrines, such as alter ego and single business enterprise, in an attempt to impose liability on the affiliate, but the court stated that it was required to apply the strict statutory requirements. Because the affiliate did not assume the landlord’s obligations and dismissal of the tenant’s fraud claim was not challenged on appeal, the court concluded that the affiliate was entitled to judgment as a matter of law.

***DeVries v. Bulldog Well Testing LLC***, Civil Action No. 7:16-CV-00338, 2017 WL 1134318 (S.D. Tex. Mar. 27, 2017). (Although the court issued this opinion in 2017, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court rejected the plaintiff’s attempt to impute the contacts of Gary Unterbrink, who allegedly managed an LLC’s day-to-day business operations, to the three individual members of the LLC. In response to the plaintiff’s attempt to invoke the “single business enterprise” doctrine, the court explained:

Plaintiffs attempt to rectify their insufficient allegations and evidence by imputing any of Unterbrink’s jurisdictional conduct onto Defendants.[footnote omitted] To support this contention, Plaintiffs cite a single Texas Supreme Court case from 2007 which discusses the “single business enterprise” theory.[footnote omitted] According to this theory, jurisdictional conduct of a corporate subsidiary may be imputed to the parent corporation.[footnote omitted] Plaintiffs contend that Unterbrink counts as Defendants’ “subsidiary,” and thus his actions may be imputed to Defendants.[footnote omitted]

Plaintiffs’ argument fails. The case Plaintiffs cite specifically states that the Texas Supreme Court has not endorsed the single business enterprise doctrine: “Here, the court of appeals held that Province and Minden operated as a single business enterprise—a theory we have never endorsed—and, therefore, Province’s Texas contacts could be imputed to Minden.”[footnote omitted] Indeed, one year later, the Texas Supreme Court expressly abrogated the single business enterprise doctrine.[footnote omitted] Even so, the Court observes a veritable chasm between Plaintiffs’ legal theory—which applies to corporations and their subsidiaries—and the facts of this case, which involve LLC members and a manager they hired. By default, LLC members are not themselves a corporate entity, and even if they were, Unterbrink is not a corporate “subsidiary” in any meaningful sense of the word.[footnote omitted]

***Ramirez v. Chenega Corporation***, EP–06–CA–0208–DB, 2006 WL 8434037 (W.D. Tex. Nov. 16, 2006). (Although the court issued this opinion in 2006, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court analyzed whether the record supported exercising personal jurisdiction over a corporation (Chenega Corporation or “Chenega”) that was the 51% member of an LLC (Chenega Integrated Systems, L.L.C. or “CIS”) based on an alter-ego relationship between Chenega and CIS. The court based its analysis on seven factors enumerated by the Fifth Circuit to determine whether a parent corporation can be held amenable to personal jurisdiction based on the acts of a subsidiary company, and the court concluded that the record did not show the requisite level of control over the day-to-day business of the subsidiary. “While the facts show Chenega exercises some degree of control over CIS, the same evidence tends to show that it was routine guidance associated with normal parent-subsidiary ownership and directorship. Chenega and CIS have maintained a degree of corporate separation that is more than superficial. . . . Nothing was presented to show a degree of control that rises to the level required by the Fifth Circuit, the degree of control required to ‘fuse the two [Defendants] for jurisdictional purposes.’”

## **M. Creditor's Remedies: Charging Order, Turnover Order, etc.**

*Cheniere Energy, Inc. v. Parallax Enterprises LLC*, No. 14-17-00982-CV, 2018 WL 6836924 (Tex. App.—Houston [14th Dist.] Dec. 27, 2018, no pet. h.) (mem. op.).

In a dispute over whether a secured note was intended to be a capital contribution rather than a loan, the court refused to enjoin the note-holder's non-judicial foreclosure of its security interest in the membership interest of the wholly owned LLC of the maker of the note, concluding that there was no showing of irreparable injury. The court reasoned that the loss of management rights in the LLC could be measured by a pecuniary standard because the only evidence of management rights that would be lost concerned management of claims in litigation, there being no argument on appeal that foreclosing on the equity interest in the LLC would disrupt any ongoing business.

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

*Barranco v. Tuscany Press, LLC*, Civil No 5-16-cv-01121-OLG, 2018 WL 7351694 (W.D. Tex. Sep. 16, 2018) (denying recovery of attorney's fees against an LLC because "it is not apparent that Texas law provides for recovery of attorney's fees from a limited liability company following a claim for breach of contract").

*Republic Capital Group, LLC v. Roberts*, No. 13-17-00481-CV, 2018 WL 5289573 (Tex. App.—Austin Oct. 25, 2018, no pet.) (mem. op.).

The trial court concluded that appellees were entitled to be awarded attorneys' fees under an indemnification clause (Paragraph 18) contained in a settlement agreement. The appellant asserted that the award of attorneys' fees was erroneous because "it is a limited liability company, not an individual or corporation, and [u]nder Chapter 38 of the Texas Civil Practice and Remedies Code, attorney's fees can only be recovered from an 'individual' or 'corporation.'" The court of appeals disagreed, noting that "appellees did not seek attorney's fees under chapter 38, nor were they awarded fees under that chapter." Instead, "they sought and were awarded fees pursuant to Paragraph 18 of the Agreement, as discussed above."

*Stabilis Fund II, LLC v. Compass Bank*, Civ. A. No. 3:18-CV-283-B, 2018 WL 3617971 (N.D. Tex. July 30, 2018) ("Texas law authorizes a party to collect attorneys' fees in some types of actions—but only from an individual or a corporation. Tex. Civ. Prac. & Rem. Code § 38.001. Section 38.001 does not authorize a party to collect attorneys' fees from a limited liability company. Because Stabilis is a limited liability company, Compass cannot collect attorneys' fees from Stabilis.").

*George Joseph Assets, LLC v. Chenevert*, 557 S.W.3d 755 (Tex. App.—Houston [14th Dist.] 2018, pet. denied) (citing § 38.001(8) of the Texas Civil Practice and Remedies Code and affirming the trial court's award of attorney's fees against defendants who were treated collectively, even though the defendants consisted of an LLC and several individuals).

*Phoneternet, LLC v. Drawbridge Design*, No. 05-17-00890-CV, 2018 WL 3238001 (Tex. App.—Dallas July 3, 2018, no pet.) (mem. op.).

"Section 38.001 of the Texas Civil Practice and Remedies Code authorizes an award of attorneys' fees for certain enumerated classes of claims brought by a 'person' against 'an individual or corporation.' Under the plain language of section 38.001, a trial court cannot order limited liability partnerships (L.L.P.), limited liability companies (L.L.C.), or limited partnerships (L.P.) to pay attorneys' fees. . . . In their second issue, appellants argue 'limited liability companies such as Phoneternet, LLC cannot be held liable for attorney fees' and therefore they 'request[ ] the court set aside the award of fees against [Phoneternet LLC].' Drawbridge Design does not dispute that Phoneternet L.L.C. is a limited liability company. Rather, it argues that because the court 'awarded fees against both the LLC and Alfia [an individual], jointly and severally' the trial court 'did not act unreasonably when entering judgment for attorneys' fees against both [a]ppellants.' However, Drawbridge Design does not cite any case law to support its contention and we find none. We conclude section 38.001 of the Texas Civil Practice and Remedies Code does not permit recovery of attorney fees against a limited liability company. The trial court erred in awarding attorney's fees against Phoneternet, L.L.C."

*Nerium SkinCare, Inc. v. Nerium International, LLC*, Civ. A. No. 3:16-CV-1217-B, 2018 WL 2323243 (N.D. Tex. Mar. 26, 2018), report and recommendation adopted, 2018 WL 2323471 (N.D. Tex. May 2, 2018).

“In its complaint, NSC seeks reasonable and necessary attorney’s fees under section 38.001 of the Texas Civil Practice and Remedies Code for the prosecution of its breach of contract claim against NI. However, NI is a limited liability company, not an ‘[i]ndividual or corporation’ within the meaning of the statute. *See* Tex. Bus. & [Com.] Code Ann. § 38.001 (‘A person may recover reasonable attorney’s fees from an individual or corporation[.]’). Every federal and state court to consider this issue, including at least four judges in this district, has determined that section 38.001 does not apply to unincorporated entities.”

*Tavakkoli v. Helwig*, Civ. A. No. 3:16-CV-2202-N, 2017 WL 10126199 (N.D. Tex. Feb. 16, 2017). (Although the court issued this opinion in 2017, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

“Helwig & Son correctly contends that Tavakkoli cannot seek recovery for his attorney’s fees under section 38.001 because Helwig & Son, a limited liability company (‘LLC’), is not an ‘individual or corporation.’ The Texas Supreme Court has not addressed whether section 38.001 permits recovery of attorney’s fees from an LLC. Several intermediate state appellate courts have held that section 38.001, by its plain language, does not allow recovery from LLCs as they are neither an ‘individual’ nor ‘corporation.’ Several federal courts, applying Texas law, have reached similar results. This Court agrees. Accordingly the Court dismisses Tavakkoli’s claim for attorney’s fees for his remaining breach of contract claim against Helwig & Son.”

#### **O. Standing or Capacity to Sue**

*Wyrick v. Business Bank of Texas, N.A.*, 2019 WL 1941839, \_\_ S.W.3d \_\_ (Tex. App.—Houston [14th Dist.] 2019, no pet. h.).

The court of appeals held that the managing members of an LLC, who had guaranteed a loan to the LLC, had standing to assert claims against the lender that arose out of conduct of the lender in procuring the guaranties from the managing members, but the managing members did not have standing to assert claims based on post-default conduct of the lender that damaged the value of the LLC’s property and interfered with the LLC’s ability to contract with third parties.

A lender made a loan to an LLC that was guaranteed by two individuals. The individuals contended that the lender assured them the lender would execute on the collateral rather than pursue the guaranties in the event of the LLC’s default on the loan. The LLC defaulted, and the lender sought to enforce the guaranties rather than foreclose on the collateral. The lender sued the guarantors, and the guarantors asserted counterclaims. The LLC asserted similar claims against the lender, but the LLC and lender agreed to arbitrate those claims pursuant to an arbitration agreement between them. The lender sought summary judgment against the guarantors on their counterclaims on the basis that they lacked standing to assert them as well as that the guarantors’ damages were too speculative. The trial court granted summary judgment without specifying the grounds.

The court of appeals first addressed the guarantors’ standing to assert counterclaims for fraud, fraud by nondisclosure, negligence, and gross negligence. Because these counterclaims and alleged injuries were based on the lender’s wrongful conduct in procuring the guaranties, as opposed to the lender’s post-default conduct that was directed at and damaged the LLC, the guarantors had a sufficient personal stake in the controversy to have standing to assert these claims (although the court of appeals ultimately affirmed the trial court’s summary judgment against the guarantors on these claims on other grounds).

As to the guarantors’ counterclaim for tortious interference with prospective contracts, the court of appeals held that the guarantors lacked standing to assert this claim because the guarantors focused on post-default conduct and sought redress for injury to the value of the LLC’s salt water disposal well and the lender’s alleged attempts to interfere with the LLC’s potential contracts after the LLC defaulted on the loan. The court acknowledged that the guarantors were the sole managing members of the LLC borrower, but the court relied on the principle that “shareholders have no independent right to bring an action for injuries suffered by the corporation even though they may sustain losses indirectly through their ownership interests.” The alleged damage to the LLC’s well was the LLC’s injury, and the guarantors lacked standing to assert these claims on the LLC’s behalf. Indeed, the LLC was

already asserting these claims in arbitration. Thus, the trial court did not err in granting summary judgment in favor of the lender on these counterclaims.

*Polaris PowerLED Technologies, LLC v. Samsung Electronics America, Inc.*, Civil Action No. 2:17-CV-00715-JRG, 2019 WL 1399927 (E.D. Tex. Mar. 28, 2019).

The party with standing to assert a patent infringement claim with regard to a patent assigned to an LLC by a member of the LLC was the LLC and not the member who contributed and assigned the patent to the LLC, notwithstanding that the member's rights under the LLC agreement included receipt of 96% of the LLC's operating cash, a drag along right that in essence could unilaterally force the sale of the LLC, and appointment of a manager who effectively had a veto right over various acts or transactions affecting the LLC's intellectual property. Despite these governance provisions, the member did not have the ability to directly control the use of the LLC's patents, and the member's rights were not sufficient to establish standing on the part of the member.

*Moss v. Princip*, 913 F.3d 508 (5th Cir. 2019).

The court affirmed the trial court's dismissal of a nondiverse partnership in a suit brought by two partners alleging claims against the other two partners for fraud, breach of fiduciary duty, breach of partnership agreement, conversion, and money had and received. The court concluded that the partnership was dispensable because all partners were party to the suit and the partnership's interests in the suit were adequately represented by the partners. Further, any risk of duplicative litigation brought by the partnership itself could be prevented by injunctive relief. The court applied the same reasoning to an LLC formed by one of the plaintiffs and one of the defendants.

The plaintiffs, separately, formed partnerships with defendant Marko Princip, whereby each plaintiff received 30% ownership in the partnership. The plaintiffs filed suit against Princip and another partner, Martin, alleging that the parties had created a partnership and that the defendants were liable for common-law fraud, breach of fiduciary duty, breach of the partnership agreement, conversion, and money had and received. The defendants removed the case to federal court from a Texas state court on the basis of diversity jurisdiction. A jury determined that a partnership existed among the parties, and the defendants moved to dismiss the claim for lack of subject-matter jurisdiction just before the entry of final judgment. The defendants argued that there was incomplete diversity due to the presence of the partnership. The plaintiffs moved to dismiss the partnership as a dispensable nondiverse party. The trial court granted the plaintiffs' motion, restoring complete diversity, and the defendants appealed.

The court of appeals first recognized that for purposes of diversity jurisdiction, a partnership is a citizen of every state in which one of its partners is a citizen. Ordinarily, diversity jurisdiction must exist at the time of removal. However, courts may dismiss nondiverse parties under Rule 21 "even after judgment has been rendered." Under Rule 19, a court can dismiss a required party who would destroy diversity if the court determines the party is dispensable. When making this determination regarding "whether, in equity and good conscience, the action should proceed among the existing parties," the court will consider four factors. These four factors are: (1) the extent to which a judgment rendered in the person's absence might prejudice that person or the existing parties; (2) the extent to which any prejudice could be lessened or avoided by protective provisions in the judgment, shaping the relief, or other measures; (3) whether a judgment rendered in the person's absence would be adequate; and (4) whether the plaintiff would have an adequate remedy if the action were dismissed for nonjoinder. As the court noted, this analysis requires a case-by-case approach.

The court noted two previous decisions of the Fifth Circuit Court of Appeals in which the court found the partnership indispensable when the claims were derivative of the partnership's interests. However, recognizing Rule 19 as a flexible and pragmatic approach, the court distinguished the two prior decisions on the basis that they involved "threatened prejudice to the partnership if the case proceeded in its absence." Further, in neither of the two cases were all constituent partners of the partnership parties to the suit. The court looked instead to decisions by sister courts in which the courts found a partnership's interest was adequately represented when all partners, or all general partners, were parties to the suit. While the court suggested the trial court could consider the tactical advantage of the partnership's presence, no such advantages were present in this case, where the partnership's role was purely passive throughout the litigation. The court acknowledged that a partnership is legally treated as a separate entity, but the court stated that "[a] partnership's interests as an entity consist of an aggregation of those interests of each of the individual partners that are relevant to the purpose of the partnership."



The court next addressed the defendants' assertion that the partnership was required to be joined as a "real party in interest" under Rule 17(a). The court pointed out that the Texas partnership statute provides for liability of a partner to a partnership or its partners for breach of the partnership agreement or violation of duties. The court commented in a footnote that some Texas courts have construed the statute to restrict partners' ability to sue for actions that have diminished the value of the partnership, but the court pointed out that these cases only address limited partnerships, and the court cited other cases indicating that the logic of these limited partnership cases is not universally accepted. The court stated that it could not conclude that the partnership was required to be joined as a plaintiff here because any interest of the partnership was fully represented and vindicated and there was no need to preserve partnership assets for all partners' benefit. The court reiterated that the partnership was a proper party but was not indispensable since its interest was fully represented by the presence of all partners. The court further explained that "the fact that an absent person could bring the action as a real party in interest does not of itself make that person a necessary or indispensable party." Although Rule 17 insures that a judgment will generally have proper effect as *res judicata* and protect a defendant from the risk of subsequent litigation, the court stated that any risk of duplicative litigation could be alleviated through properly tailored protective provisions in the judgment (such as injunctive relief prohibiting the plaintiffs from suing the defendants on behalf of the partnership on claims the partnership could have raised in the suit and ordering the plaintiffs to cause the partnership to release the claims as a condition of judgment).

The defendants also raised essentially the same challenges based on the presence of an LLC formed by one of the plaintiffs and one of the defendants. The court stated that the defendants did not argue that the LLC should be treated differently from the partnership, and the court stated that its analysis extended to the LLC, which was also dismissed by the district court.

In sum, the court concluded that the partnership and LLC were not indispensable parties, and the court remanded the case in order for the district court to consider appropriate injunctive relief to guard against any risk of duplicative litigation.

***Katz v. Intel Pharma, LLC***, Civ. A. No. H-18-1347, 2018 WL 4701566 (S.D. Tex. Oct. 1, 2018).

Plaintiff's lawsuit asserted breach of fiduciary duty, aiding and abetting a breach of fiduciary duty, and other claims. The trial court denied a motion to dismiss.

Terry Katz brought a derivative action on behalf of Intel Pharma, LLC against Ntel Pharma, LLC, Ntel Nutra, Inc., and Landon Suggs. Among other claims, Katz asserted breach of fiduciary duty against Suggs and aiding and abetting a breach of fiduciary duty against Ntel Pharma and Ntel Nutra. In essence, Katz claimed that he was a 25% owner of Intel and that Suggs and Angel Echevarria (Intel's President) stole the business by transferring all or substantially all of Intel's assets to Ntel Pharma and later to Ntel Nutra.

The defendants moved to dismiss on various grounds, including that Katz's claims were based on an alleged oral agreement with Suggs to acquire a 25% interest in Intel, and that Katz had not pleaded sufficient facts to support an inference of an enforceable contract. Katz argued, in part, that he alleged facts about the contract simply to show that, because he had a 25% ownership interest, he had standing to bring a derivative suit.

The court observed that Katz's claims were properly considered under § 101.463 of the Business Organizations Code, which provides special rules for closely held LLCs. Under § 101.463, a "closely held limited liability company" is an LLC with "(1) fewer than 35 members; and (2) no membership interests listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national securities association." According to the court, Katz alleged that Suggs was the sole owner of Intel before he offered Katz a 25% interest, "meaning that Intel had fewer than 35 members and that its membership interests are not listed on a national exchange." The court ultimately concluded that Katz's allegations withstood dismissal:

"Sections 101.452–101.459 [of the Business Organizations Code] do not apply to a closely held limited liability company." § 101.463(b); *see also Lonestar Logo*, 552 S.W.3d at 348–49. "The import and effect of this exemption, as the Texas Supreme Court has observed in regard to the parallel provisions that govern shareholder-derivative suits, are that 'the Legislature has enacted special rules to allow its shareholders to more easily bring a derivative suit on behalf of the corporation,' including 'without having to prove that they "fairly and adequately represent[ ] the interests of" the corporation, without having to make a "demand" upon the corporation, as in other derivative actions, and without fear of a stay or dismissal based on actions of other corporate

actors in response to a demand.”” *Id.* at 349 (quoting *Ritchie v. Rupe*, 443 S.W.3d 856, 880–81 (Tex. 2014) (citations omitted)). Section 101.463 also provides:

[i]f justice requires:

(1) a derivative proceeding brought by a member of a closely held limited liability company may be treated by a court as a direct action brought by the member for the member’s own benefit; and

(2) a recovery in a direct or derivative proceeding by a member may be paid directly to the plaintiff or to the limited liability company if necessary to protect the interests of creditors or other members of the limited liability company.

Even if Intel is a closely held corporation, Katz must establish himself as a member of the LLC to bring a derivative suit. The complaint alleges that Katz had a 25% ownership interest in Intel and that both Suggs and Echevarria corroborated Katz’s interest in writing. A membership interest is a bundle of economic rights in the LLC, including the right to receive distributions. *See* TEX. BUS. ORG. CODE § 1.002(54). The complaint alleges that Katz received the right to income distributions from Intel based on his ownership interest and that he received at least two distributions. Viewing the complaint in the light most favorable to Katz, the factual allegations are sufficient to permit Katz’s derivative claims. The fact that Katz repeatedly alleges the existence of a contract with Suggs to receive the ownership interest in Intel does not support dismissal.

***In re Dean***, Case No. 16-43088-mxm-7, 2018 WL 4810700 (Bankr. N.D. Tex. Sept. 29, 2018).

The bankruptcy court rejected the claims of the parties, including breach of fiduciary duty and breach of contract in an LLC setting.

John Lester (“Lester”), Mary Lester, and Nedra Dean formed Staffing Dynamics International, L.P. The primary focus of the business was providing placement and staffing of medical personnel for the partnership’s clients. The principals later converted Staffing Dynamics into an LLC (Staffing Dynamics International, L.L.C., or “SDI”). Pursuant to the plan of conversion, John Lester and Nedra Dean became the only two managers and members of SDI, each holding a 50% ownership interest.

Disputes and disagreements between Lester and Dean eventually developed. Dean filed for bankruptcy, and in their Liquidation Complaint, John Lester and/or SDI asserted multiple causes of action against her. (As will be discussed below, Dean sued Lester as well.) In part, Lester alleged that Dean prevented him from performing his duties under the operating agreement and violated his statutory and contractual rights to manage SDI. After discussing each of Lester’s allegations, the court concluded that there was no credible evidence to support them. Lester and SDI also alleged that Dean, by acting unilaterally, breached the “Major Decision Clause” of the operating agreement (requiring all members to approve defined “Major Decisions”). Once again, the court found that the allegations lacked merit.

Lester and SDI also asserted a breach-of-fiduciary-duty claim against Dean. The court initially observed that Dean “did not formally concede that she owed a fiduciary duty to a fellow SDI member (John Lester), as opposed to the unquestionable fiduciary duty she owed to SDI.” Lester “did not plead or prove an informal fiduciary relationship between John Lester and Nedra Dean to support a finding that Nedra Dean owed him a fiduciary duty. *See Fed. Ins. Co. v. Rodman*, 2011 WL 5921529 (N.D. Tex. Nov. 29, 2011) (stating that there is no formal fiduciary relationship created as a matter of law between members of an LLC, but recognizing that an informal fiduciary relationship may arise under particular circumstances where there is a close, personal relationship of trust and confidence).” The court continued:

Generally, the elements of a claim for breach of fiduciary duty are (1) the existence of a fiduciary duty, (2) breach of the duty, (3) causation, and (4) damages. Although the Texas Supreme Court has recognized that a plaintiff may not need to prove actual damages when seeking equitable relief, the court has reaffirmed that a plaintiff must show causation and actual damages when asserting a claim for the loss of money. In their breach-of-fiduciary-duty count, John Lester and SDI allege, “As a proximate result of [Dean’s] breach of fiduciary duty, Lester and SDI have suffered economic harm in an amount to be proven at trial.” John Lester and SDI also seek to have this economic claim declared nondischargeable, as discussed below. Therefore, John Lester and SDI must prove damages to support their breach-of-fiduciary-duty claims.

John Lester and SDI allege that Nedra Dean breached her duties of care, honesty, undivided loyalty, and fidelity by “her self-dealing and usurping business opportunities as described herein, including, but not limited to those acts of self-dealing designed to divert business opportunities away from SDI to Dean and her family.” John Lester and SDI do not specify the alleged breaches of fiduciary duty, but the Court assumes that John Lester and SDI are referring to the same self-dealing allegations covered above with respect [to] violations of John Lester’s right to manage and perform his management duties, and breaches of contract. The Court already addressed most of those allegations and found they had no merit.

The court then examined the report of an independent auditor who conducted a forensic audit and accounting of SDI for the years 2012-2014. Lester and SDI asserted that the report revealed that Dean misappropriated assets of Lester and SDI for personal gain. After an extensive analysis of the report’s findings, the court disagreed, largely on the basis that there was no credible evidence of any damages suffered by Lester or SDI, or because there was insufficient credible evidence to support a breach of duty.

Dean also asserted that Lester breached his fiduciary duties to SDI and to her through various misdeeds, and she similarly sued Lester for breach of the LLC agreement. The court rejected her claims:

First, the vast majority of Nedra Dean’s allegations relate to harm that John Lester allegedly caused SDI. Nedra Dean is no longer a member of SDI, and she does not have standing, individually or derivatively, to assert SDI’s causes of action, including breach of a fiduciary duty owed to SDI.

Second, Nedra Dean did not plead or prove an informal fiduciary relationship between John Lester and Nedra Dean to support a finding that John Lester owed her a fiduciary duty.

Third, even if John Lester did owe a fiduciary duty to Nedra Dean herself, Nedra Dean did not provide credible evidence of damages to her individually (including her purported mental anguish), as opposed to derivative harm caused by injury to SDI.

...

[T]he vast majority of Nedra Dean’s allegations relate to harm that John Lester allegedly caused SDI. Nedra Dean is no longer a member of SDI, and she does not have standing, individually or derivatively, to assert SDI’s causes of action, including breach of contract with SDI.

[E]ven if John Lester’s actions could be considered some type of breach of the Limited Partnership Agreement or LLC Agreement, Nedra Dean, as a purported contract-counterparty, did not provide credible evidence of damages to her individually (including purported mental anguish), as opposed to derivative harm caused by injury to SDI.

***Nguyen v. Bank of America***, No. 17-20758, 2018 WL 3097178 (5th Cir. June 22, 2018).

“These public records indicate that the property at issue is wholly owned by Tri Investment Group, LLC, not Nguyen [an individual]. Even if Nguyen is the manager of Tri Investment Group, LLC, ‘[a] member of a limited liability company or an assignee of a membership interest in a limited liability company does not have an interest in any specific property of the company.’ Tex. Bus. Orgs. Code § 101.106(b). Therefore, he [Nguyen] lacks standing to pursue his appeal.”

***Thoede v. Wortham***, No. 05-17-00191-CV, 2018 WL 3342692 (Tex. App.—Dallas July 9, 2018, no pet.) (mem. op.) (“When conducting business under an assumed name, a certificate must be filed with the appropriate county clerk. TEX. BUS. & COM. CODE § 71.054. This is true for individuals and entities. *See, e.g.*, TEX. BUS. & COM. CODE § 71.051 (individuals); *id.* § 71.101 (limited liability companies). Failure to comply with these provisions prevents a party from maintaining an action in a Texas court arising out of a contract in which the assumed name was used until an original, new, or renewed certificate has been filed but does not prevent that person from defending an action or creating an independent ground of liability for a corporate obligation. TEX. BUS. & COM. CODE § 71.201(a).”).

*County of El Paso v. Navar*, No. 08-17-00058-CV, 2018 WL 2715298 (Tex. App.—El Paso June 6, 2018, no pet.).

“Only the party whose primary legal right has been breached has standing. ‘Without breach of a legal right belonging to the plaintiff no cause of action can accrue to his benefit.’ *Nobles v. Marcus*, 533 S.W.2d 923, 927 (Tex. 1976) (only the defrauded party may bring suit to set aside a deed obtained by fraud). To have standing, ‘a plaintiff must demonstrate that he or she possesses an interest in a conflict distinct from that of the general public, such that the defendant’s actions have caused the plaintiff some particular injury.’ *Sneed v. Webre*, 465 S.W.3d 169, 180 (Tex. 2015) (quoting *Williams v. Lara*, 52 S.W.3d 171, 178-79 (Tex. 2001)). For example, an individual stakeholder in a legal entity does not have standing to recover personally for harms done to the legal entity. Likewise, a limited partner lacks standing to assert claims individually for injuries to the partnership that merely diminish the value of the partnership interests or reduce his share of partnership income because those claims belong to the partnership itself. The same is true for a member of a limited liability company. ‘It is the nature of the wrong, whether directed against the entity only or against the individual stakeholder, and not the existence of injury, that determines who may sue.’”

*Platinum Air Group, LLC v. Short’s Travel, Management, Inc.*, 3:10-CV-01576-P, 2010 WL 11619032 (N.D. Tex. Oct. 13, 2010) (Although the court issued this opinion in 2010, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court denied a motion to dismiss alleging that an LLC lacked the capacity to sue.

Platinum Air Group, LLC (“Platinum”) filed a complaint against Short’s Travel Management, Inc. (“Short’s”) alleging a breach-of-contract claim. Short’s filed a motion to dismiss on the basis that Platinum had forfeited its existence and lacked the capacity to sue. The court noted that, under Texas law, “if a corporation’s privileges are forfeited pursuant to subchapter F of chapter 171 of the Texas Tax Code, the corporation shall be denied the right to sue or defend.” However, “[i]f a corporation can show that it has returned to active status before the lawsuit has been dismissed then the corporation will maintain the capacity to sue regardless of whether it lacked that capacity at the time of the initial [f]iling.”

Platinum submitted evidence to the court that it had returned to active status prior to dismissal of the lawsuit. As a result, the court denied Short’s motion to dismiss as well as its request for attorney’s fees.

## **P. Direct and Derivative Claims**

*Moss v. Princip*, 913 F.3d 508 (5th Cir. 2019).

The court affirmed the trial court’s dismissal of a nondiverse partnership in a suit brought by two partners alleging claims against the other two partners for fraud, breach of fiduciary duty, breach of partnership agreement, conversion, and money had and received. The court concluded that the partnership was dispensable because all partners were party to the suit and the partnership’s interests in the suit were adequately represented by the partners. Further, any risk of duplicative litigation brought by the partnership itself could be prevented by injunctive relief. The court applied the same reasoning to an LLC formed by one of the plaintiffs and one of the defendants.

The plaintiffs, separately, formed partnerships with defendant Marko Princip, whereby each plaintiff received 30% ownership in the partnership. The plaintiffs filed suit against Princip and another partner, Martin, alleging that the parties had created a partnership and that the defendants were liable for common-law fraud, breach of fiduciary duty, breach of the partnership agreement, conversion, and money had and received. The defendants removed the case to federal court from a Texas state court on the basis of diversity jurisdiction. A jury determined that a partnership existed among the parties, and the defendants moved to dismiss the claim for lack of subject-matter jurisdiction just before the entry of final judgment. The defendants argued that there was incomplete diversity due to the presence of the partnership. The plaintiffs moved to dismiss the partnership as a dispensable nondiverse party. The trial court granted the plaintiffs’ motion, restoring complete diversity, and the defendants appealed.

The court of appeals first recognized that for purposes of diversity jurisdiction, a partnership is a citizen of every state in which one of its partners is a citizen. Ordinarily, diversity jurisdiction must exist at the time of removal. However, courts may dismiss nondiverse parties under Rule 21 “even after judgment has been rendered.” Under Rule 19, a court can dismiss a required party who would destroy diversity if the court determines the party is dispensable. When making this determination regarding “whether, in equity and good conscience, the action

should proceed among the existing parties,” the court will consider four factors. These four factors are: (1) the extent to which a judgment rendered in the person’s absence might prejudice that person or the existing parties; (2) the extent to which any prejudice could be lessened or avoided by protective provisions in the judgment, shaping the relief, or other measures; (3) whether a judgment rendered in the person’s absence would be adequate; and (4) whether the plaintiff would have an adequate remedy if the action were dismissed for nonjoinder. As the court noted, this analysis requires a case-by-case approach.

The court noted two previous decisions of the Fifth Circuit Court of Appeals in which the court found the partnership indispensable when the claims were derivative of the partnership’s interests. However, recognizing Rule 19 as a flexible and pragmatic approach, the court distinguished the two prior decisions on the basis that they involved “threatened prejudice to the partnership if the case proceeded in its absence.” Further, in neither of the two cases were all constituent partners of the partnership parties to the suit. The court looked instead to decisions by sister courts in which the courts found a partnership’s interest was adequately represented when all partners, or all general partners, were parties to the suit. While the court suggested the trial court could consider the tactical advantage of the partnership’s presence, no such advantages were present in this case, where the partnership’s role was purely passive throughout the litigation. The court acknowledged that a partnership is legally treated as a separate entity, but the court stated that “[a] partnership’s interests as an entity consist of an aggregation of those interests of each of the individual partners that are relevant to the purpose of the partnership.”

The court next addressed the defendants’ assertion that the partnership was required to be joined as a “real party in interest” under Rule 17(a). The court pointed out that the Texas partnership statute provides for liability of a partner to a partnership or its partners for breach of the partnership agreement or violation of duties. The court commented in a footnote that some Texas courts have construed the statute to restrict partners’ ability to sue for actions that have diminished the value of the partnership, but the court pointed out that these cases only address limited partnerships, and the court cited other cases indicating that the logic of these limited partnership cases is not universally accepted. The court stated that it could not conclude that the partnership was required to be joined as a plaintiff here because any interest of the partnership was fully represented and vindicated and there was no need to preserve partnership assets for all partners’ benefit. The court reiterated that the partnership was a proper party but was not indispensable since its interest was fully represented by the presence of all partners. The court further explained that “the fact that an absent person could bring the action as a real party in interest does not of itself make that person a necessary or indispensable party.” Although Rule 17 insures that a judgment will generally have proper effect as *res judicata* and protect a defendant from the risk of subsequent litigation, the court stated that any risk of duplicative litigation could be alleviated through properly tailored protective provisions in the judgment (such as injunctive relief prohibiting the plaintiffs from suing the defendants on behalf of the partnership on claims the partnership could have raised in the suit and ordering the plaintiffs to cause the partnership to release the claims as a condition of judgment).

The defendants also raised essentially the same challenges based on the presence of an LLC formed by one of the plaintiffs and one of the defendants. The court stated that the defendants did not argue that the LLC should be treated differently from the partnership, and the court stated that its analysis extended to the LLC, which was also dismissed by the district court.

In sum, the court concluded that the partnership and LLC were not indispensable parties, and the court remanded the case in order for the district court to consider appropriate injunctive relief to guard against any risk of duplicative litigation.

***Katz v. Intel Pharma, LLC***, Civ. A. No. H-18-1347, 2018 WL 4701566 (S.D. Tex. Oct. 1, 2018).

Plaintiff’s lawsuit asserted breach of fiduciary duty, aiding and abetting a breach of fiduciary duty, and other claims. The trial court denied a motion to dismiss.

Terry Katz brought a derivative action on behalf of Intel Pharma, LLC against Ntel Pharma, LLC, Ntel Nutra, Inc., and Landon Suggs. Among other claims, Katz asserted breach of fiduciary duty against Suggs and aiding and abetting a breach of fiduciary duty against Ntel Pharma and Ntel Nutra. In essence, Katz claimed that he was a 25% owner of Intel and that Suggs and Angel Echevarria (Intel’s President) stole the business by transferring all or substantially all of Intel’s assets to Ntel Pharma and later to Ntel Nutra.

The defendants moved to dismiss on various grounds, including that Katz’s claims were based on an alleged oral agreement with Suggs to acquire a 25% interest in Intel, and that Katz had not pleaded sufficient facts to

support an inference of an enforceable contract. Katz argued, in part, that he alleged facts about the contract simply to show that, because he had a 25% ownership interest, he had standing to bring a derivative suit.

The court observed that Katz's claims were properly considered under § 101.463 of the Business Organizations Code, which provides special rules for closely held LLCs. Under § 101.463, a "closely held limited liability company" is an LLC with "(1) fewer than 35 members; and (2) no membership interests listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national securities association." According to the court, Katz alleged that Suggs was the sole owner of Intel before he offered Katz a 25% interest, "meaning that Intel had fewer than 35 members and that its membership interests are not listed on a national exchange." The court ultimately concluded that Katz's allegations withstood dismissal:

"Sections 101.452–101.459 [of the Business Organizations Code] do not apply to a closely held limited liability company." § 101.463(b); *see also Lonestar Logo*, 552 S.W.3d at 348–49. "The import and effect of this exemption, as the Texas Supreme Court has observed in regard to the parallel provisions that govern shareholder-derivative suits, are that 'the Legislature has enacted special rules to allow its shareholders to more easily bring a derivative suit on behalf of the corporation,' including 'without having to prove that they "fairly and adequately represent[ ] the interests of" the corporation, without having to make a "demand" upon the corporation, as in other derivative actions, and without fear of a stay or dismissal based on actions of other corporate actors in response to a demand.'" *Id.* at 349 (quoting *Ritchie v. Rupe*, 443 S.W.3d 856, 880–81 (Tex. 2014) (citations omitted)). Section 101.463 also provides:

[i]f justice requires:

(1) a derivative proceeding brought by a member of a closely held limited liability company may be treated by a court as a direct action brought by the member for the member's own benefit; and

(2) a recovery in a direct or derivative proceeding by a member may be paid directly to the plaintiff or to the limited liability company if necessary to protect the interests of creditors or other members of the limited liability company.

Even if Intel is a closely held corporation, Katz must establish himself as a member of the LLC to bring a derivative suit. The complaint alleges that Katz had a 25% ownership interest in Intel and that both Suggs and Echevarria corroborated Katz's interest in writing. A membership interest is a bundle of economic rights in the LLC, including the right to receive distributions. *See* TEX. BUS. ORG. CODE § 1.002(54). The complaint alleges that Katz received the right to income distributions from Intel based on his ownership interest and that he received at least two distributions. Viewing the complaint in the light most favorable to Katz, the factual allegations are sufficient to permit Katz's derivative claims. The fact that Katz repeatedly alleges the existence of a contract with Suggs to receive the ownership interest in Intel does not support dismissal.

***In re Dean***, Case No. 16-43088-mxm-7, 2018 WL 4810700 (Bankr. N.D. Tex. Sept. 29, 2018).

The bankruptcy court rejected the claims of the parties, including breach of fiduciary duty and breach of contract in an LLC setting.

John Lester ("Lester"), Mary Lester, and Nedra Dean formed Staffing Dynamics International, L.P. The primary focus of the business was providing placement and staffing of medical personnel for the partnership's clients. The principals later converted Staffing Dynamics into an LLC (Staffing Dynamics International, L.L.C., or "SDI"). Pursuant to the plan of conversion, John Lester and Nedra Dean became the only two managers and members of SDI, each holding a 50% ownership interest.

Disputes and disagreements between Lester and Dean eventually developed. Dean filed for bankruptcy, and in their Liquidation Complaint, John Lester and/or SDI asserted multiple causes of action against her. (As will be discussed below, Dean sued Lester as well.) In part, Lester alleged that Dean prevented him from performing his duties under the operating agreement and violated his statutory and contractual rights to manage SDI. After discussing each of Lester's allegations, the court concluded that there was no credible evidence to support them. Lester and SDI also alleged that Dean, by acting unilaterally, breached the "Major Decision Clause" of the operating agreement (requiring all members to approve defined "Major Decisions"). Once again, the court found that the allegations lacked merit.

Lester and SDI also asserted a breach of fiduciary duty claim against Dean. The court initially observed that Dean “did not formally concede that she owed a fiduciary duty to a fellow SDI member (John Lester), as opposed to the unquestionable fiduciary duty she owed to SDI.” Lester “did not plead or prove an informal fiduciary relationship between John Lester and Nedra Dean to support a finding that Nedra Dean owed him a fiduciary duty. *See Fed. Ins. Co. v. Rodman*, 2011 WL 5921529 (N.D. Tex. Nov. 29, 2011) (stating that there is no formal fiduciary relationship created as a matter of law between members of an LLC, but recognizing that an informal fiduciary relationship may arise under particular circumstances where there is a close, personal relationship of trust and confidence).” The court continued:

Generally, the elements of a claim for breach of fiduciary duty are (1) the existence of a fiduciary duty, (2) breach of the duty, (3) causation, and (4) damages. Although the Texas Supreme Court has recognized that a plaintiff may not need to prove actual damages when seeking equitable relief, the court has reaffirmed that a plaintiff must show causation and actual damages when asserting a claim for the loss of money. In their breach-of-fiduciary-duty count, John Lester and SDI allege, “As a proximate result of [Dean’s] breach of fiduciary duty, Lester and SDI have suffered economic harm in an amount to be proven at trial.” John Lester and SDI also seek to have this economic claim declared nondischargeable, as discussed below. Therefore, John Lester and SDI must prove damages to support their breach-of-fiduciary-duty claims.

John Lester and SDI allege that Nedra Dean breached her duties of care, honesty, undivided loyalty, and fidelity by “her self-dealing and usurping business opportunities as described herein, including, but not limited to those acts of self-dealing designed to divert business opportunities away from SDI to Dean and her family.” John Lester and SDI do not specify the alleged breaches of fiduciary duty, but the Court assumes that John Lester and SDI are referring to the same self-dealing allegations covered above with respect [to] violations of John Lester’s right to manage and perform his management duties, and breaches of contract. The Court already addressed most of those allegations and found they had no merit.

The court then examined the report of an independent auditor who conducted a forensic audit and accounting of SDI for the years 2012-2014. Lester and SDI asserted that the report revealed that Dean misappropriated assets of Lester and SDI for personal gain. After an extensive analysis of the report’s findings, the court disagreed, largely on the basis that there was no credible evidence of any damages suffered by Lester or SDI, or because there was insufficient credible evidence to support a breach of duty.

Dean also asserted that Lester breached his fiduciary duties to SDI and to her through various misdeeds, and she similarly sued Lester for breach of the LLC agreement. The court rejected her claims:

First, the vast majority of Nedra Dean’s allegations relate to harm that John Lester allegedly caused SDI. Nedra Dean is no longer a member of SDI, and she does not have standing, individually or derivatively, to assert SDI’s causes of action, including breach of a fiduciary duty owed to SDI.

Second, Nedra Dean did not plead or prove an informal fiduciary relationship between John Lester and Nedra Dean to support a finding that John Lester owed her a fiduciary duty.

Third, even if John Lester did owe a fiduciary duty to Nedra Dean herself, Nedra Dean did not provide credible evidence of damages to her individually (including her purported mental anguish), as opposed to derivative harm caused by injury to SDI.

...  
[T]he vast majority of Nedra Dean’s allegations relate to harm that John Lester allegedly caused SDI. Nedra Dean is no longer a member of SDI, and she does not have standing, individually or derivatively, to assert SDI’s causes of action, including breach of contract with SDI.

[E]ven if John Lester’s actions could be considered some type of breach of the Limited Partnership Agreement or LLC Agreement, Nedra Dean, as a purported contract-counterparty, did not provide credible evidence of damages to her individually (including purported mental anguish), as opposed to derivative harm caused by injury to SDI.

*Cardwell v. Gurley*, No. 05-09-01068-CV, 2018 WL 3454800 (Tex. App.—Dallas July 18, 2018, pet. denied) (mem. op.).

The court of appeals affirmed the trial court’s judgment that Donald Cardwell had breached his fiduciary duty.

Donald Cardwell and Bill Gurley were each 50% members in 121 Investments, LLC (“121 Investments”). The LLC was member-managed, and it was formed to purchase property and to construct an office building. Cardwell was the managing member, and he had exclusive control and management rights in the company. After Cardwell engaged in various real estate transactions, Gurley sued Cardwell, individually and derivatively on behalf of 121 Investments, for breach of fiduciary duty. The trial court entered a final judgment in favor of Gurley, and Cardwell appealed.

Cardwell argued that the trial court erred in concluding that he owed Gurley a fiduciary duty. He contended that, in a member-managed LLC, he and Gurley did not owe fiduciary duties to each other. Further, he did not owe an informal fiduciary duty “because they were simply businessmen interacting as equals.” Cardwell did not challenge the trial court’s ruling that he owed a fiduciary duty to 121 Investments.

In its findings and conclusions, the trial court had stated the following: “Cardwell, as the managing member of 121 Investments, owed the LLC fiduciary duties of loyalty and due care as a matter of law. Since Gurley was the only other member of the LLC, such fiduciary duties accrued, and were therefore also owed, directly to Gurley by Cardwell as a matter of law.” The court of appeals largely ducked the question of whether the trial court’s conclusion with respect to Gurley was correct:

The legislature has enacted special provisions allowing shareholders of closely-held corporations and limited liability companies to more easily bring a derivative suit on behalf of the company. The current provision relating to limited liability companies gives a trial court discretion to treat “a derivative proceeding brought by a member of a closely held limited liability company . . . as a direct action brought by the member for the member’s own benefit” and to order “a recovery in a direct or derivative proceeding by a member [to be] paid directly to the plaintiff or to the limited liability company if necessary to protect the interests of creditors or other members of the limited liability company.” BUS. ORGS. § 101.463(c) (West 2012). A closely-held limited liability company is defined as a company with less than thirty-five shareholders and “no shares listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national securities association.” *Id.* at § 101.463(a). Article 5.14(L)(1) of the now-superseded Texas Business Corporations Act (TBCA), and its successor in the TBOC, include the same provision for closely-held corporations. And, at all times relevant to this case, article 8.12 of the TLLCA provided that TBCA article 5.14 also applied to limited liability companies and their members, managers, and officers.

Gurley properly brought his claims individually and derivatively on behalf of 121 Investments, which falls within the definition of a closely-held limited liability company. Both the final judgment and the findings of fact and conclusions of law reflect the trial court’s determination that Gurley was entitled to a direct recovery on both his individual claim and his derivative claim on behalf of 121 Investments for “damages incurred by himself and by 121 Investments as a result of Cardwell’s breaches of fiduciary duties.” And, Cardwell admits he owed a fiduciary duty to 121 Investments. Because the trial court’s findings of fact and conclusions of law regarding Ca[r]dwell’s fiduciary duty to 121 Investments is sufficient to independently support the trial court’s judgment, we need not address whether there is factually sufficient evidence to support the trial court’s findings and conclusions regarding Ca[r]dwell’s fiduciary duty to Gurley individually.

#### **Q. Divorce of Member**

*Mason v. Mason*, No. 03-17-00546-CV, 2019 WL 1967166 (Tex. App.—Austin May 3, 2019, no pet. h.) (mem. op.).

The court of appeals affirmed the trial court’s determination in a divorce proceeding that a husband wasted community resources based on payment by the husband’s LLC of expenses incurred for the husband’s gambling, travel, hotels, and adult entertainment (such payments being equated by the court as distributions by the LLC during



the marriage). The court of appeals also affirmed the trial court's award of reimbursement of the community estate based on the benefit to the husband's separate-property membership interest inuring from funds loaned to the LLC by the community estate.

At issue in this case were determinations the trial court made in the divorce of Jeff and Keri Mason relating to a single-member LLC owned by Jeff as his separate property. In dividing the community estate, the trial court first found in favor of Keri on a constructive fraud claim based on "wasteful" expenditures by Jeff and reconstituted the community estate by adding over \$752,324 to the community estate. The trial court also characterized Jeff's LLC as separate property and awarded the community estate reimbursement of \$283,051 from Jeff's separate estate for outstanding loans made by the community estate to the LLC.

Keri's claim for constructive fraud was based on expenditures totaling \$752,324 paid by Jeff's LLC for Jeff's gambling, travel, hotels, and adult entertainment during the pendency of the divorce in violation of a standing order that was in effect at the time. The trial court determined that the payment of these expenses by the LLC amounted to a distribution to Jeff, which he wasted to the detriment of the community.

The court of appeals explained that an LLC is a separate legal entity and that the property owned by the LLC is neither separate nor community property. Tex. Bus. Orgs. Code § 101.106(b) ("A member of a limited liability company or an assignee of a membership interest does not have an interest in any specific property of the company."). However, distributions to a member from an LLC during the member's marriage are considered community property even if the membership interest is owned as separate property. Jeff disputed that the payments of the expenses at issue were distributions because the expenditures were charged by Jeff on the LLC's credit card, were paid directly to the vendors, and were treated by the LLC and its accountants as business expenses. The court of appeals concluded, however, that the record fell short of establishing that the expenditures were legitimate business expenditures, and the trial court did not abuse its discretion in finding that Jeff committed constructive fraud.

Next the court addressed Jeff's challenges to the trial court's judgment of reimbursement of the community in the amount of \$283,051 from Jeff's separate estate based on loans totaling \$599,000 from the community estate to the LLC, which was owned by Jeff as his separate property. Jeff asserted that there was no evidence that his separate estate as opposed to the LLC itself benefitted from or was enhanced by the loan. The court made clear that the community estate was not entitled to reimbursement based solely on the fact that Jeff was the sole member and manager of the LLC (noting in a footnote that reverse veil piercing may be applied in exceptional circumstances to characterize property of a corporation as belonging to the community, and pointing out that a claim of alter ego may in some instances have the same effect as a claim for reimbursement). The court disagreed with Jeff, however, as to the sufficiency of the evidence to show that Jeff's separate estate benefitted from the loans to the LLC.

The court of appeals reiterated the point that LLC property is neither community nor separate property and acknowledged that the funds transferred to the LLC were not subject to division on divorce because they became LLC property and lost their community character when they were transferred to the LLC. However, the community estate could seek reimbursement of the transferred funds based on Jeff's membership interest in the LLC, which was property subject to characterization and which was in this case Jeff's separate property. To prevail on her reimbursement claim based on Jeff's membership interest, Keri had to establish that Jeff's membership interest was "benefitted or enhanced" by the community estate. Jeff argued that there was no evidence that his membership interest became more valuable as a result of the loans, or that the evidence did not show that any enhanced value amounted to \$283,051. Of the \$599,000 in loans from the community estate to the LLC, \$50,000 was repaid, approximately \$266,000 was used to fund retirement contributions for Jeff and Keri, \$33,051 was used to fund other employees' retirements, and Jeff and Keri disputed whether the remaining funds were repaid in the form of Jeff's salary or were used for "cash flow" for the LLC. The court concluded that the trial court could reasonably have concluded on the record that the loans from the community estate benefitted Jeff's separate-property membership interest.

The court discussed different measures of enhancement in value and concluded that the measure used for "improvements to another marital estate"—the difference between fair market value before and after the improvements—was not applicable to Jeff's membership interest. Rather, like reimbursement claims for uncompensated time and effort expended to the benefit of stock belonging to a marital estate, the court concluded that a reimbursement claim for funds expended to benefit a membership interest belonging to a separate estate may be measured by the cost of the contribution to the community estate. The court of appeals said the evidence was

sufficient to support the finding that the cost of the loans to the community was \$283,051, and the trial court did not abuse its discretion in concluding the contribution cost was the proper measure of reimbursement.

Finally, the court of appeals considered and rejected Jeff's argument that the decision to reimburse \$281,051 to the community estate was inequitable. The court agreed with Jeff that there was some evidence to support his contention that the community received at least some benefit from the loans and Jeff's membership interest in the form of subsequent wages and distributions, but the court said the trial court could have reasonably inferred that the LLC would continue to operate after the divorce as a result of the loans and that Jeff would continue to enjoy the same distribution benefits as part of his separate estate.

*Mathis v. Mathis*, No. 01-17-00449-CV, 2018 WL 6613864 (Tex. App.—Houston [1st Dist.] Dec. 18, 2018, no pet. h.) (mem. op.).

The court of appeals held that the trial court in a divorce action did not err in characterizing an interest in an LLC as community property owned by the husband as opposed to being owned by another entity owned by the husband, but the court of appeals reversed the trial court with respect to valuation of these entities, finding that neither the wife's nor the husband's opinion on the value of these closely held entities had any evidentiary support.

The trial court granted a divorce to Ronald and Karen Mathis and awarded Ronald ownership interests in two closely held entities while Karen was awarded an equalized judgment. On appeal, Ronald argued that the trial court made various errors with respect to the two closely held entities that resulted in an excessive equalized judgment and manifestly unfair and unjust property division. Among Ronald's contentions were that the trial court mischaracterized an ownership interest in an LLC as a community asset and treated bank accounts of another entity as divisible community assets.

On appeal, Ronald argued that the trial court mischaracterized as a community asset an ownership interest in Nations Baseball, a closely held LLC. Although Ronald testified at trial that he owned the interest at issue in Nations Baseball, on appeal Ronald argued that Nations Baseball was owned by a corporate entity—South Texas Baseball—which was undisputedly a community-owned entity. Thus, Ronald argued that the trial court should only have divided the interest in South Texas Baseball, not the interests of both entities. The court of appeals reviewed the evidence, which included testimony in which Ronald referred to himself as a “shareholder” in Nations Baseball. Karen also testified that any ownership in Nations Baseball was held by Ronald as community property. The documentary evidence was conflicting with respect to whether Ronald or South Texas Baseball owned the interest in Nations Baseball (K-1 showing South Texas Baseball as having a 19.2% interest in Nations Baseball, Ronald's inventory describing South Texas Baseball as having a sole asset of a 19.2% interest in Nations Baseball, and a balance sheet of Nations Baseball showing Ronald as a member with a capital account and share of distributions). In view of the conflicting evidence, the trial court did not err in classifying the ownership interest in Nations Baseball as a distinct and divisible community asset.

The court of appeals next discussed the valuation of the interests in Nations Baseball and South Texas Baseball. At trial, neither party presented expert testimony on valuation. The trial court valued the interests of Nations Baseball and South Texas Baseball at the amounts listed by Karen in her inventory, \$200,000 and \$500,000, respectively. Ronald took the position that both entities were worth zero but acknowledged that they could “possibly” be of some value to a potential buyer. Karen's testimony on value did not match her inventories and did not align with the manner in which she claimed to have calculated the value. In the course of its discussion, the court of appeals mentioned certain bank accounts that were identified by all parties as accounts of South Texas Baseball but were treated by the trial court as distinct community assets subject to division. In a footnote, the court made the point that corporate assets are owned by the corporation and are not subject to division as part of the community estate absent a finding of alter ego. Karen did not argue alter ego, and there was no mention by the trial court in its findings and conclusions of any theory that would transform the accounts into divisible community property; therefore, there was insufficient evidence for the trial court to list these balances as distinct, divisible community assets.

The court explained that the method used as a general rule to value community property for purposes of division in a divorce is “market value,” but Karen's valuations were not supported by the market value method for various reasons, the most significant being that they were closely held entities and “the sale of their shares was restricted.” The court stated that “[m]arket value is not an appropriate valuation method when the property being valued is community-owned shares in a closely held entity that are subject to sale restrictions. . . . In that situation, the fair market value is zero, but there are other valuation methods that may be used to determine the value of an

interest in a closely held entity.” Ronald’s position that the value of the interests in the entities was zero was consistent with case law regarding the value of shares in a closely held company subject to sale restrictions, but the court reiterated that market value is not an appropriate valuation method in this context. Other valuation methods identified by the court included the actual value of the property to the owner, the comparable sales method, and a method specified in the corporate documents. Neither party attempted to use any of these methods at trial (although the court noted in a footnote that the “shareholder agreement” of Nations Baseball provided a process for valuing a member’s interest for purposes of the company’s buyout of a member’s interest on dissociation of the member). In sum, neither party supplied the trial court with sufficient evidence to perform the task of ordering a just and right division of the community estate. Thus, the appellate court reversed and remanded the property division for further proceedings in the trial court.

*In re Marriage of Hudson*, No. 16-18-00011-CV, 2018 WL 4656288 (Tex. App.—Texarkana Sept. 28, 2018, no pet.) (mem. op.).

The court of appeals agreed with the trial court’s conclusion that property transferred from an LLC to one spouse during the marriage was community property.

David Hudson and Frances Ruben were married. Before the marriage, Ruben’s separate estate acquired a 1.95 acre tract of land by adverse possession. During the marriage, Ruben conveyed this land to Franz Events, LLC. Both before and after this conveyance to the LLC, Hudson made significant loans and contributions toward capital and noncapital improvements to the company and the land. Hudson also paid for material and supplies for the company. After Hudson filed for divorce (but still during the marriage), the LLC conveyed the land, structure, and all personal property in connection with the operation of Franz Events to Ruben. The warranty deed evidencing the conveyance showed that Ruben was the grantee, but it did not contain any indication that it was conveyed to her as her separate property or that she paid for the conveyance with her separate property funds.

The trial court concluded that the transferred land, improvements, and property of Franz Events was community property. Ruben challenged the conclusion, but the court of appeals agreed with the trial court:

These findings of fact established that Ruben originally acquired the 1.95-acre tract prior to her marriage. However, when property is conveyed to an entity such as a partnership or limited liability company, it becomes the property of the entity and loses its separate or community character. *Lifshutz v. Lifshutz*, 199 S.W.3d 9, 27 (Tex. App.—San Antonio 2006, pet. denied); *Marshall v. Marshall*, 735 S.W.2d 587, 594 (Tex. App.—Dallas 1987, writ ref’d n.r.e.). Thus, while the 1.95-acre tract was owned by the LLC, it was neither separate property nor community property. This was also true of the structures and personal property acquired by the LLC, both before and during the marriage.

Further, distributions from the LLC “are considered community property, regardless of whether the distribution is of income or of an asset.” *Lifshutz*, 199 S.W.3d at 27 (citing *Marshall*, 735 S.W.2d at 594); *see also Gonzales v. Maggio*, 500 S.W.3d 656, 668 (Tex. App.—Austin 2016, no pet.) (distributions made in winding up of an entity become part of the community estate). Thus, when the LLC conveyed all of its assets to Ruben during the marriage, those assets became a part of the community estate. Consequently, we find that the unchallenged and implied findings of fact support the trial court’s conclusion of law that Ruben failed to meet her burden of proving that the real and personal property connected with the operation of Franz Events was her separate property. We overrule this issue.

## **R. Bankruptcy**

*Rodriguez v. Cyr (In re Cyr)*, Case No. 18-50102-CAG, Adv. No. 18-05227-CAG, 2019 WL 1495137 (Bankr. W.D. Tex. Apr. 1, 2019).

Because LLC property is not the property of the members, the court rejected the bankruptcy trustee’s argument that the transfer of an LLC’s assets constituted an indirect transfer by the member of its interest in the LLC for purposes of fraudulent transfer claims.

The bankruptcy trustee alleged that an LLC’s transfer of all of its assets to a related LLC (which was owned by a self-settled spendthrift trust of the debtor) constituted a fraudulent transfer by the debtor as owner of the

transferor LLC. The trustee argued that the transfer of the transferor LLC's assets was an indirect transfer of the debtor member's interest because it effectively transferred the value of the debtor's membership interest to the self-settled trust. The court rejected the trustee's argument because the property transferred was property of the LLC rather than the debtor. The court explained:

In Texas, “[a] member of a limited liability company . . . does not have an interest in any specific property of the company.” Tex. Bus. Org. Code Ann. § 101.106(b). Therefore, as sole member of OSI, Debtor had no interest in the assets and business transferred from OSI to SA Spine. Accordingly, the Court agrees that the Trustee has failed to allege that [sic] a transfer of an interest of the debtor.

Further, the court rejected the trustee's argument that it should invoke its equity powers:

The Trustee encourages the Court to use its equity powers to “delve behind the form of the transactions and relationships to determine the substance.” . . . This Court will not use its equity powers to override the law. While this Court may be a court of equity, this Court is of the opinion that equity follows the law.

***Garner v. Sherwood (In re Jones)***, Case No. 16-41283-ELM-7, Adv. No. 18-04098 (Bankr. N.D. Tex. Mar. 11, 2019).

The court rejected the bankruptcy trustee's claim that the debtor made a preferential transfer to an “insider” where the transferees were co-members with the debtor in an LLC but were not insiders of the debtor himself.

The bankruptcy trustee alleged that a pre-bankruptcy transfer of funds by Jones, the debtor in bankruptcy, to Richard and Lesa Sherwood was a preferential transfer to an insider. The Sherwoods moved for summary judgment on the trustee's claim. The trustee relied on the co-ownership and managerial roles of Jones and the Sherwoods in an LLC and characterized Jones and the Sherwoods as insiders of the LLC. The court stated that the trustee's focus missed the mark, however, because the relevant inquiry was whether the Sherwoods were insiders of the debtor, Jones, not insiders of the LLC. With respect to statutory insider status, the trustee did not allege that either of the Sherwoods were general partners of Jones, and to the extent the trustee implied the existence of a general partnership based on the Sherwoods' co-ownership of the LLC with Jones and the existence of a revenue sharing agreement with the LLC and Jones, the court said that there was no summary judgment evidence of the LLC's existence as a partnership; rather, the record indicated the LLC was an LLC. The record also did not show non-statutory insider status, as there was no significant probative evidence that the transaction was not conducted at arm's length.

***In re Blevins***, Case No. 17-60019-rlj7, 2019 WL 575664 (Bankr. N.D. Tex. Feb. 12, 2019).

The court discussed concerns raised by the bankruptcy trustee regarding the structure and operations of an LLC in light of bankruptcy rules regarding fee sharing among persons entitled to compensation under the Bankruptcy Code. The court referred to “confusion” and “lack of transparency caused by counsel's misstatements in identifying who was actually debtors' counsel” and explained that the issues stemmed from the business model of Law Solutions Chicago LLC, which attempts to provide centralized consumer bankruptcy representation on a nationwide scale. The court pointed to questions about whether the LLC is actually a law firm and whether its “partners” are, at least in part, “regular associates.” The court did not reach any conclusions on these issues because the court ordered disgorgement of all fees to the debtors to resolve mistakes made by counsel in the case.

***In re Dean***, Case No. 16-43088-mxm-7, 2018 WL 4810700 (Bankr. N.D. Tex. Sept. 29, 2018).

The bankruptcy court rejected the claims of the parties (including breach of fiduciary duty and breach of contract in an LLC setting) and concluded that there were no grounds for denying the bankrupt petitioner (a manager and 50% member of the LLC) her discharge.

John Lester (“Lester”), Mary Lester, and Nedra Dean formed Staffing Dynamics International, L.P. The primary focus of the business was providing placement and staffing of medical personnel for the partnership's clients. The principals later converted Staffing Dynamics into an LLC (Staffing Dynamics International, L.L.C.,

or “SDI”). Pursuant to the plan of conversion, John Lester and Nedra Dean became the only two managers and members of SDI, each holding a 50% ownership interest.

Disputes and disagreements between Lester and Dean eventually developed. Dean filed for bankruptcy, and in their Liquidation Complaint, John Lester and/or SDI asserted multiple causes of action against her. (As will be discussed below, Dean sued Lester as well.) In part, Lester alleged that Dean prevented him from performing his duties under the operating agreement and violated his statutory and contractual rights to manage SDI. After discussing each of Lester’s allegations, the court concluded that there was no credible evidence to support them. Lester and SDI also alleged that Dean, by acting unilaterally, breached the “Major Decision Clause” of the operating agreement (requiring all members to approve defined “Major Decisions”). Once again, the court found that the allegations lacked merit.

Lester and SDI also asserted a breach-of-fiduciary-duty claim against Dean. The court initially observed that Dean “did not formally concede that she owed a fiduciary duty to a fellow SDI member (John Lester), as opposed to the unquestionable fiduciary duty she owed to SDI.” Lester “did not plead or prove an informal fiduciary relationship between John Lester and Nedra Dean to support a finding that Nedra Dean owed him a fiduciary duty. *See Fed. Ins. Co. v. Rodman*, 2011 WL 5921529 (N.D. Tex. Nov. 29, 2011) (stating that there is no formal fiduciary relationship created as a matter of law between members of an LLC, but recognizing that an informal fiduciary relationship may arise under particular circumstances where there is a close, personal relationship of trust and confidence).” The court continued:

Generally, the elements of a claim for breach of fiduciary duty are (1) the existence of a fiduciary duty, (2) breach of the duty, (3) causation, and (4) damages. Although the Texas Supreme Court has recognized that a plaintiff may not need to prove actual damages when seeking equitable relief, the court has reaffirmed that a plaintiff must show causation and actual damages when asserting a claim for the loss of money. In their breach-of-fiduciary-duty count, John Lester and SDI allege, “As a proximate result of [Dean’s] breach of fiduciary duty, Lester and SDI have suffered economic harm in an amount to be proven at trial.” John Lester and SDI also seek to have this economic claim declared nondischargeable, as discussed below. Therefore, John Lester and SDI must prove damages to support their breach-of-fiduciary-duty claims.

John Lester and SDI allege that Nedra Dean breached her duties of care, honesty, undivided loyalty, and fidelity by “her self-dealing and usurping business opportunities as described herein, including, but not limited to those acts of self-dealing designed to divert business opportunities away from SDI to Dean and her family.” John Lester and SDI do not specify the alleged breaches of fiduciary duty, but the Court assumes that John Lester and SDI are referring to the same self-dealing allegations covered above with respect [to] violations of John Lester’s right to manage and perform his management duties, and breaches of contract. The Court already addressed most of those allegations and found they had no merit.

The court then examined the report of an independent auditor who conducted a forensic audit and accounting of SDI for the years 2012-2014. Lester and SDI asserted that the report revealed that Dean misappropriated assets of Lester and SDI for personal gain. After an extensive analysis of the report’s findings, the court disagreed, largely on the basis that there was no credible evidence of any damages suffered by Lester or SDI, or because there was insufficient credible evidence to support a breach of duty.

In their Discharge Complaint, Lester and SDI asserted that § 523(a)(4) of the Bankruptcy Code excepts from Dean’s discharge any debt “for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.” They further alleged that the auditor’s report made findings of fraud, defalcation, and embezzlement. The court disagreed:

The report made no such findings, and the evidence admitted in this trial is not sufficient for the Court to make those findings.

Fraud in a fiduciary capacity under § 523(a)(4) requires positive fraud involving moral turpitude or intentional wrong. Defalcation under § 523(a)(4) requires a culpable state of mind involving knowledge of, or gross recklessness with respect to, the improper nature of the fiduciary behavior. If actual knowledge of wrongdoing is lacking, the reckless conduct requires a fiduciary

who consciously disregards (or is willfully blind to) a substantial and unjustifiable risk that his behavior will result in a violation of fiduciary duty. Finally, embezzlement under § 523(a)(4) is the fraudulent appropriation of property by a person who is entrusted with that property or who has possession of it lawfully. There must be proof of the debtor’s fraudulent intent in taking the property.

After carefully considering all of the evidence at trial, and after weighing the credibility of the many witnesses, the Court finds and concludes that there is insufficient evidence of Nedra Dean’s culpable state of mind—including moral turpitude or intentional wrong (fraud), knowledge of, or gross recklessness with respect to, the improper nature of the fiduciary behavior (defalcation), and fraudulent intent (embezzlement)—to except any debt of Nedra Dean from discharge under 11 U.S.C. § 523(a)(4).

As the Consultant’s Report notes, there were many instances of unequal “distributions” (or salary) to the members Nedra Dean and John Lester. But the totality of the evidence demonstrates that Nedra Dean, for the most part, was working tirelessly and in good faith to help SDI succeed, or at the very end, to help SDI avoid unnecessary damages to SDI’s contract counterparties given SDI’s precarious financial condition and the severe infighting between the members. The unequal distributions suggest not moral turpitude or intentional wrong by Nedra Dean, but instead the recognition that Nedra Dean was entitled to get paid for her sweat equity while John Lester abandoned his duties, and that Nedra Dean needed the distributions for living expenses. The Court cannot find moral turpitude or intentional wrong based on this record.

Lester and SDI also asserted the exception to discharge under § 523(a)(6) “for willful and malicious injury by the debtor to another entity or to the property of another entity.” The court observed that “[t]his provision requires ‘a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury.’” The court found insufficient evidence that Dean was willful and malicious in her actions. Various other exceptions to discharge were discussed (§§ 727(a)(2)-(5), 707(b)(3)), but the court rejected them all.

## **S. Fraudulent Transfer**

*Rodriguez v. Cyr (In re Cyr)*, Case No. 18-50102-CAG, Adv. No. 18-05227-CAG, 2019 WL 1495137 (Bankr. W.D. Tex. Apr. 1, 2019).

Because LLC property is not the property of the members, the court rejected the bankruptcy trustee’s argument that the transfer of an LLC’s assets constituted an indirect transfer by the member of its interest in the LLC for purposes of fraudulent transfer claims.

The bankruptcy trustee alleged that an LLC’s transfer of all of its assets to a related LLC (which was owned by a self-settled spendthrift trust of the debtor) constituted a fraudulent transfer by the debtor as owner of the transferor LLC. The trustee argued that the transfer of the transferor LLC’s assets was an indirect transfer of the debtor member’s interest because it effectively transferred the value of the debtor’s membership interest to the self-settled trust. The court rejected the trustee’s argument because the property transferred was property of the LLC rather than the debtor. The court explained:

In Texas, “[a] member of a limited liability company . . . does not have an interest in any specific property of the company.” Tex. Bus. Org. Code Ann. § 101.106(b). Therefore, as sole member of OSI, Debtor had no interest in the assets and business transferred from OSI to SA Spine. Accordingly, the Court agrees that the Trustee has failed to allege that [sic] a transfer of an interest of the debtor.

Further, the court rejected the trustee’s argument that it should invoke its equity powers:

The Trustee encourages the Court to use its equity powers to “delve behind the form of the transactions and relationships to determine the substance.” . . . This Court will not use its equity powers to override the law. While this Court may be a court of equity, this Court is of the opinion that equity follows the law.

*Garner v. Sherwood (In re Jones)*, Case No. 16-41283-ELM-7, Adv. No. 18-04098 (Bankr. N.D. Tex. Mar. 11, 2019).

The court rejected the bankruptcy trustee's claim that the debtor made a preferential transfer to an "insider" where the transferees were co-members with the debtor in an LLC but were not insiders of the debtor himself.

The bankruptcy trustee alleged that a pre-bankruptcy transfer of funds by Jones, the debtor in bankruptcy, to Richard and Lesa Sherwood was a preferential transfer to an insider. The Sherwoods moved for summary judgment on the trustee's claim. The trustee relied on the co-ownership and managerial roles of Jones and the Sherwoods in an LLC and characterized Jones and the Sherwoods as insiders of the LLC. The court stated that the trustee's focus missed the mark, however, because the relevant inquiry was whether the Sherwoods were insiders of the debtor, Jones, not insiders of the LLC. With respect to statutory insider status, the trustee did not allege that either of the Sherwoods were general partners of Jones, and to the extent the trustee implied the existence of a general partnership based on the Sherwoods' co-ownership of the LLC with Jones and the existence of a revenue sharing agreement with the LLC and Jones, the court said that there was no summary judgment evidence of the LLC's existence as a partnership; rather, the record indicated the LLC was an LLC. The record also did not show non-statutory insider status, as there was no significant probative evidence that the transaction was not conducted at arm's length.

*Galaz v. Galaz*, 850 F.3d 800 (5th Cir. 2017).

The court affirmed the district court's judgment awarding the assignee of an LLC membership interest actual and exemplary damages based on the fraudulent transfer of the LLC's assets by the assignee's ex-husband, from whom the assignee had received her membership interest in their divorce.

When Lisa and Raul Galaz divorced, Lisa was awarded half of Raul's 50% membership interest in Artist Rights Foundation, LLC ("ARF"), which held certain music royalty rights. After the divorce, Raul transferred the LLC's royalty rights to Segundo Suenos, which was not organized as an entity at the time but was later organized as an LLC owned by Raul's father. After Lisa filed for bankruptcy, she brought this adversary proceeding against Raul, his father, and Segundo Suenos, LLC ("Segundo"), alleging a fraudulent transfer of the assets of ARF to Segundo that defrauded Lisa of her interest in ARF. After a bench trial, the bankruptcy court found that the transfer of assets from ARF to Segundo Suenos was invalid and that it was a fraudulent transfer under the Texas Uniform Fraudulent Transfer Act. The bankruptcy court held Raul and Segundo liable and awarded actual and exemplary damages to Lisa. After an appeal to the district court and remand back to the bankruptcy court, the bankruptcy court awarded actual and exemplary damages consistent with the district court's instructions, and the defendants again appealed to the district court, which affirmed. On appeal to the Fifth Circuit, the appellate court determined that Lisa's claims were non-core bankruptcy claims and remanded for the district court to enter final judgment after further consideration. After further proceedings that included findings of fact and conclusions of law by the bankruptcy court, the district court adopted those findings of fact and conclusions of law, invalidating the transfer of assets from ARF to Segundo and awarding Lisa actual and exemplary damages. Raul and Segundo again appealed.

In this opinion, the Fifth Circuit affirmed the district court, concluding that "[t]he district court did not clearly err in adopting the bankruptcy court's finding of fraudulent intent. The presence of [six] badges of fraud is sufficient evidence that Raul transferred ARF's royalty rights with the actual intent of defrauding Lisa of her 25 percent economic interest in ARF." The appellate court found no error in the district court's award of \$241,309 in actual damages and \$250,000 in exemplary damages against Raul and Segundo.

## **T. Power of Eminent Domain**

*Graves v. Lone Star NGL Pipeline LP*, No. 09-18-00173-CV, 2019 WL 962544 (Tex. App.—Beaumont Feb. 28, 2019, no pet. h.) (mem. op.).

The court of appeals affirmed the trial court's summary judgment in favor of a limited partnership seeking to exercise the power of eminent domain. The court held that authority to make the requisite declaration of necessity had been properly delegated to the CEO of the LLC that was the sole member of the general partner of the limited partnership.

Lone Star NGL Pipeline LP ("Lone Star") planned to construct a natural gas pipeline that would run through Liberty County, and the route was determined after an engineering and design study. A map of the route

was attached to a Consent of Member in Lieu of a Meeting (the “Consent”) signed by Kelcy Warren. Warren was the CEO of Lone Star NGL Asset Holdings II LLC (the “Company”), and the Company was the sole member of Lone Star NGL Asset GP LLC (“Lone Star GP LLC”), the sole general partner of Lone Star. The Consent outlined the relationship of the various Lone Star entities and stated that the Company, as the sole member of the general partner of Lone Star, found and determined “that public convenience, public use and necessity require that it is in the public interest” for Lone Star to acquire the land along the route. Certain landowners were unhappy with the proposed route, which traveled diagonally through their property, and Lone Star began condemnation proceedings after negotiations for an adjustment of the route failed. The landowners sought dismissal of the proceedings, arguing that Lone Star failed to establish necessity because the Consent was not executed by someone with authority to do so. The trial court denied the landowners’ plea to the jurisdiction and motion to dismiss and granted a partial summary judgment in favor of Lone Star pursuant to which the only remaining issue for determination was the amount of just compensation due to the landowners. The landowners appealed.

The landowners challenged the validity of the determination of necessity by contending that Lone Star “presented no evidence that its governing body either determined necessity or delegated authority to exercise eminent domain.” The landowners’ attack focused on Warren’s authority to sign the Consent and the relationship of the various Lone Star entities and their predecessors. The court noted that “a corporation, general partnership, limited partnership, limited liability company, or *other combination of those entities* engaged as a common carrier in the pipeline business for the purpose of transporting oil, oil products, gas . . . or other mineral solutions has all the rights and powers conferred on a common carrier by Sections 111.019-111.022, Natural Resources Code.” Tex. Bus. Orgs. Code Ann. § 2.105. (emphasis added by court). Section 111.019(b) of the Texas Natural Resources Code provides that in exercising the power of eminent domain, common carriers “may enter on and condemn the land, rights-of-way, easements, and property of any person or corporation necessary for the construction, maintenance, or operation of the common carrier pipeline.” The court stated that necessity is presumed from a determination by the condemnor unless a statute requires affirmative pleading and proof. A condemnor has the burden to show that the board of directors or other governing body or authority with power to speak made a determination of necessity, and this showing may be made through a board resolution or other evidence.

The court quoted at length from the Consent, including multiple recitals and resolutions in which the Company (in its capacity as the sole member of Lone Star GP LLC, acting general partner of Lone Star) determined the public necessity of acquiring the landowners’ property.

The landowners complained that Lone Star did not produce corporate documents relating to the authority or structure of the entities in support of the summary judgment but instead produced the affidavit of the secretary of the Company to prove up the consent. The court noted that the Consent, along with other evidence, revealed “a combination of [Lone Star] entities” engaged in the business of constructing pipelines for the transportation of natural gas liquids as referred to in Tex. Bus. Orgs. Code Ann. § 2.105. The secretary’s affidavit outlined the history and relationship of the Lone Star entities and attached various documents, including the LLC agreements of the Company and Lone Star GP LLC. The LLC agreements addressed the management of Lone Star GP LLC and the powers of the officers of the Company and Lone Star GP LLC. The evidence submitted by Lone Star with its motion for summary judgment established that, at the time Warren executed the Consent, he was the chairman and CEO of the Company (which was formerly known by another name), which was the sole member of Lone Star GP LLC (which was formerly known by another name), which was the general partner of Lone Star (which was formerly known by another name). The landowners argued, however, that Lone Star was required to prove that the governing agreements authorized Warren, as CEO of the Company, to declare a necessity to use eminent domain “singly.”

The court pointed out provisions of the LLC agreement of the Company and actions of the sole member of the Company supporting Warren’s authority and concluded that, even assuming the LLC agreement of the Company did not expressly confer authority on Warren to “singly” sign a Consent determining public necessity, other evidence established that Lone Star and the Company ratified Warren’s declaration of necessity in the Consent. The court thus concluded that Lone Star’s general partner, acting through its sole member, duly determined the public necessity and that the Consent form coupled with the Company’s ratification of the Consent sufficiently established public necessity.

The landowners further argued that the Company was not the sole member of Lone Star GP LLC, but the court concluded that the evidence clearly established that the Company was the sole member of Lone Star GP LLC despite a mistaken reference in the LLC agreement of Lone Star GP LLC.



Finally, the landowners complained that “an officer signed the Consent, not the member, and nothing grants any agent, manager or officer the power of eminent domain.” (Presumably, although it is not entirely clear from the opinion, this reference to “the member” is a reference to the Company itself, as the sole member of the general partner, as opposed to the Company’s member, which was yet another LLC.) While the power to determine necessity for purposes of eminent domain may be validly delegated, the landowners asserted that the officers of the Company lacked express authority to authorize condemnation. The court responded that the evidence made “clear that the member is governed by the officers, who are authorized to act on behalf of the company,” and that the secretary’s affidavit specifically declared that “the general partner of Lone Star NGL Pipeline LP has throughout the Lone Star pipeline project at issue delegated responsibility to officers of the general partner and their designees, including” the engineer whose study was the basis for determining the proposed route. The court further relied on the Delaware LLC statute (the entities were organized in Delaware and agreed that Delaware law would govern their agreements), which provides that, unless otherwise provided in the LLC agreement:

a member or manager of a limited liability company has the power and authority to delegate to 1 or more other persons any or all of the member’s or manager’s, as the case may be, rights, powers and duties to manage and control the business and affairs of the limited liability company. Any such delegation may be to agents, officers and employees of a member or manager or the limited liability company[.]

6 Del. C. § 18-407. The court said that it would interpret the Company’s LLC agreement to grant all necessary powers to the officers to conduct the affairs of the company, unless specifically proscribed, citing 6 Del. C. § 18-1101(b) (“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 landowners argued that the secretary’s affidavit should be ignored because it attempted to redefine the express terms of the LLC agreements of the Company and Lone Star GP LLC. In essence, the landowners argued that orders, resolutions, and minutes were the only acceptable evidence of official company proceedings. The court rejected this argument, stating that the eminent domain statutes do not limit the type of evidence that may be presented by a condemnor in this respect.

In sum, the court concluded that Lone Star conclusively established that authority had been properly delegated to Warren, the CEO of the Company, and that the Consent executed by Warren as the CEO of the sole member of Lone Star’s general partner contained a valid declaration of necessity.

## **U. Diversity Jurisdiction**

Federal district courts and the Fifth Circuit Court of Appeals continue to hold that the citizenship of a limited liability company, like that of a partnership, is determined by the citizenship of each of the members. The cases are too numerous to include in this paper, but cases presenting somewhat unusual circumstances or arguments are included below.

*Moss v. Princip*, 913 F.3d 508 (5th Cir. 2019).

The court affirmed the trial court’s dismissal of a nondiverse partnership in a suit brought by two partners alleging claims against the other two partners for fraud, breach of fiduciary duty, breach of partnership agreement, conversion, and money had and received. The court concluded that the partnership was dispensable because all partners were party to the suit and the partnership’s interests in the suit were adequately represented by the partners. Further, any risk of duplicative litigation brought by the partnership itself could be prevented by injunctive relief. The court applied the same reasoning to an LLC formed by one of the plaintiffs and one of the defendants.

The plaintiffs, separately, formed partnerships with defendant Marko Princip, whereby each plaintiff received 30% ownership in the partnership. The plaintiffs filed suit against Princip and another partner, Martin, alleging that the parties had created a partnership and that the defendants were liable for common-law fraud, breach of fiduciary duty, breach of the partnership agreement, conversion, and money had and received. The defendants removed the case to federal court from a Texas state court on the basis of diversity jurisdiction. A jury determined that a partnership existed among the parties, and the defendants moved to dismiss the claim for lack of subject-matter jurisdiction just before the entry of final judgment. The defendants argued that there was incomplete

diversity due to the presence of the partnership. The plaintiffs moved to dismiss the partnership as a dispensable nondiverse party. The trial court granted the plaintiffs' motion, restoring complete diversity, and the defendants appealed.

The court of appeals first recognized that for purposes of diversity jurisdiction, a partnership is a citizen of every state in which one of its partners is a citizen. Ordinarily, diversity jurisdiction must exist at the time of removal. However, courts may dismiss nondiverse parties under Rule 21 "even after judgment has been rendered." Under Rule 19, a court can dismiss a required party who would destroy diversity if the court determines the party is dispensable. When making this determination regarding "whether, in equity and good conscience, the action should proceed among the existing parties," the court will consider four factors. These four factors are: (1) the extent to which a judgment rendered in the person's absence might prejudice that person or the existing parties; (2) the extent to which any prejudice could be lessened or avoided by protective provisions in the judgment, shaping the relief, or other measures; (3) whether a judgment rendered in the person's absence would be adequate; and (4) whether the plaintiff would have an adequate remedy if the action were dismissed for nonjoinder. As the court noted, this analysis requires a case-by-case approach.

The court noted two previous decisions of the Fifth Circuit Court of Appeals in which the court found the partnership indispensable when the claims were derivative of the partnership's interests. However, recognizing Rule 19 as a flexible and pragmatic approach, the court distinguished the two prior decisions on the basis that they involved "threatened prejudice to the partnership if the case proceeded in its absence." Further, in neither of the two cases were all constituent partners of the partnership parties to the suit. The court looked instead to decisions by sister courts in which the courts found a partnership's interest was adequately represented when all partners, or all general partners, were parties to the suit. While the court suggested the trial court could consider the tactical advantage of the partnership's presence, no such advantages were present in this case, where the partnership's role was purely passive throughout the litigation. The court acknowledged that a partnership is legally treated as a separate entity, but the court stated that "[a] partnership's interests as an entity consist of an aggregation of those interests of each of the individual partners that are relevant to the purpose of the partnership."

The court next addressed the defendants' assertion that the partnership was required to be joined as a "real party in interest" under Rule 17(a). The court pointed out that the Texas partnership statute provides for liability of a partner to a partnership or its partners for breach of the partnership agreement or violation of duties. The court commented in a footnote that some Texas courts have construed the statute to restrict partners' ability to sue for actions that have diminished the value of the partnership, but the court pointed out that these cases only address limited partnerships, and the court cited other cases indicating that the logic of these limited partnership cases is not universally accepted. The court stated that it could not conclude that the partnership was required to be joined as a plaintiff here because any interest of the partnership was fully represented and vindicated and there was no need to preserve partnership assets for all partners' benefit. The court reiterated that the partnership was a proper party but was not indispensable since its interest was fully represented by the presence of all partners. The court further explained that "the fact that an absent person could bring the action as a real party in interest does not of itself make that person a necessary or indispensable party." Although Rule 17 insures that a judgment will generally have proper effect as *res judicata* and protect a defendant from the risk of subsequent litigation, the court stated that any risk of duplicative litigation could be alleviated through properly tailored protective provisions in the judgment (such as injunctive relief prohibiting the plaintiffs from suing the defendants on behalf of the partnership on claims the partnership could have raised in the suit and ordering the plaintiffs to cause the partnership to release the claims as a condition of judgment).

The defendants also raised essentially the same challenges based on the presence of an LLC formed by one of the plaintiffs and one of the defendants. The court stated that the defendants did not argue that the LLC should be treated differently from the partnership, and the court stated that its analysis extended to the LLC, which was also dismissed by the district court.

In sum, the court concluded that the partnership and LLC were not indispensable parties, and the court remanded the case in order for the district court to consider appropriate injunctive relief to guard against any risk of duplicative litigation.

***Momentum Engineering, LLC v. Tabler***, No. 14-18-00002-CV, 2018 WL 4037411 (Tex. App.—Houston [14th Dist.] Aug. 23, 2018, pet. filed).

“Tabler next argues that the trial court has personal jurisdiction over Momentum because Momentum is a limited liability company with a member who resides in Houston. In support of this position, Tabler relies on *Americold Realty Trust v. Conagra Foods, Inc.*, — U.S. —, 136 S.Ct. 1012, 1015, 194 L.Ed.2d 71 (2016), in which the Supreme Court of the United States held that, for the purpose of federal diversity jurisdiction, an unincorporated association is a citizen of every place in which a member is a citizen. Because that principle applies to a limited liability company only when identifying its citizenship for the purpose of diversity jurisdiction in a federal court, the case does not support the trial court’s ruling.

The question of whether a federal court has diversity jurisdiction over a given case is a distinct inquiry from whether a court has personal jurisdiction over a defendant. Such restrictions on a federal court’s subject-matter jurisdiction are the result of the limited nature of the federal judiciary’s powers. The requirements applicable to personal jurisdiction, on the other hand, flow from the Due Process Clause and protect individual liberty interests. Thus, a federal court can have diversity jurisdiction over a case and yet lack personal jurisdiction over the foreign defendant.

Tabler’s reliance on *Americold* is misplaced because that case concerned only the determination of an unincorporated association’s citizenship for the purpose of establishing diversity jurisdiction in a federal court. It is true that certain specific factors may be sufficient both to establish citizenship for diversity-jurisdiction purposes and to establish general personal jurisdiction. For example, for the purpose of diversity jurisdiction, a corporation is a citizen of the place in which it was incorporated and the place in which it has its principal place of business, *see* 26 U.S.C. § 1332(c), and the place of incorporation and principal place of business also are the “paradig[m] . . . bases for general jurisdiction.” *Daimler AG v. Bauman*, 571 U.S. 117, 137, 134 S.Ct. 746, 187 L.Ed.2d 624 (2014) (quoting *Lea Brilmayer et al., A General Look at General Jurisdiction*, 66 TEX. L. REV. 721, 735 (1988) (alteration in original)). But Tabler cites no authority, nor have we found any, holding that a limited liability company is subject to general personal jurisdiction in every State in which a member is a citizen. The rule instead is that limited liability companies are treated as partnerships for the purpose of federal diversity jurisdiction, but they are treated as corporations for the purpose of general personal jurisdiction.

We conclude that the citizenship of a limited liability company’s members is not a factor to be considered, for when evaluating personal jurisdiction, we consider only the defendant’s contacts, and a limited liability company is a distinct legal entity from its members.”

***Lyons v. Prime Car Wash Investments, Inc.***, Civ. A. No. H-07-3451, 2008 WL 11389419 (S.D. Tex. Aug. 27, 2008). (Although the court issued this opinion in 2008, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court granted a motion to remand on the basis that it lacked subject matter jurisdiction over the case.

Lyons, Jr. was one of three members of Prime Centers, LLC (“Prime Centers”). Lyons and others sued Prime Centers. The court explained that subject matter jurisdiction in a diversity case exists only if there is complete diversity among the parties. The court stated the general rule that the citizenship of all partners, limited and general, controls the citizenship of a limited partnership. The court further observed that the citizenship of a limited liability company is determined in the same manner, i.e., by looking to the citizenship of the company’s members.

Prime Centers was composed of three members: (1) The Piersall Group, Inc. (“Piersall Group”); (2) Bobbie Carson (“Carson”); and (3) Lyons, Jr. Piersall Group was a corporation organized under the laws of California, with its principal place of business in California. For diversity purposes, it was a citizen of California. *See* 28 U.S.C. § 1332(c)(1). Carson was a citizen of California. Lyons, Jr. was a citizen of Texas. Accordingly, the court concluded that Prime Centers, L.L.C. was a citizen of both Texas and California and was not completely diverse from Plaintiff Lyons.

Lyons and others argued that the citizenship of Lyons as a member of Prime Centers should not be allowed to defeat diversity jurisdiction because it leads to the “illogical” result that his citizenship is being construed twice, once as a plaintiff and once as a member of the defendant limited liability company. The court rejected the argument:

Although [*Carden v. Arkoma Associates*, 494 U.S. 185 (1990)] did not expressly address the issue of a plaintiff partner (member) bringing a claim against his partnership (limited liability

company), the Fifth Circuit has refused to recognize an exception to the *Carden* rule despite acknowledging that the rule “effectively closes the doors of the federal courts to many lawsuits among partners or by partners against a partnership.” *Bankston v. Burch*, 27 F.3d 164, 168-69 (5th Cir. 1994) (citing *Whalen v. Carter*, 954 F.2d 1087, 1095 (5th Cir. 1992)). The court finds that *Carden* controls and that Prime Centers, L.L.C. is a citizen of Texas for diversity purposes. *See, e.g., Boulder Creek Co. v. Maruko, Inc.*, 772 F. Supp. 1150, 1153 (C.D. Ca. 1991) (holding that, post-*Carden*, the citizenship of a limited partner in a suit against the limited partnership cannot be disregarded even though it means construing the citizenship of the limited partner twice, once as a plaintiff and once as a member of the defendant partnership). As such, complete diversity of citizenship does not exist between the parties, and the court lacks subject matter jurisdiction over this case. Remand is, therefore, appropriate.

## V. Personal Jurisdiction

***EnerQuest Oil & Gas, L.L.C. v. Antero Resources Corporation***, No. 02-18-000178-CV, 2019 WL 1583921 (Tex. App.—Fort Worth Apr. 11, 2019, no pet. h.) (mem. op.).

The court held that an Oklahoma LLC that was headquartered in Oklahoma and had no offices or employees in Texas was not subject to specific personal jurisdiction in Texas even though the LLC was registered to transact business in Texas and conducted “some business” in Texas, and even though the LLC contracted with a Texas resident to form an LLC whose principal place of business would be in Texas. The court also rejected the notion that an email exchange constituted “reaching out” to Texas to misappropriate trade secrets.

Antero Resources Corporation (“Antero”) sought to intervene in this case and add EnerQuest Oil & Gas, L.L.C. (“EnerQuest”), an Oklahoma LLC, as a defendant, alleging that EnerQuest benefitted from the misappropriation of Antero’s trade secrets. The trial court denied EnerQuest’s special appearance, and EnerQuest appealed. The court of appeals agreed with EnerQuest that EnerQuest lacked sufficient minimum contacts to establish personal jurisdiction.

Antero argued that the trial court’s exercise of personal jurisdiction over EnerQuest was proper based on the following: (1) EnerQuest was registered to transact business in Texas and did transact business in Texas; (2) EnerQuest contracted with a Texas resident by entering into an agreement to form an LLC subsidiary whose principal place of business was in Texas; and (3) EnerQuest committed a tort in Texas when it “reached out” to Texas to solicit, fund, and acquire trade secrets that were sent from Texas.

First, the court of appeals concluded that the undisputed facts that EnerQuest was registered to transact business in Texas and conducted “some business” (operating oil and gas wells in Texas) were not enough to establish personal jurisdiction when they had no connection to Antero’s causes of action. The court commented that registering to do business and maintaining a registered agent are factors in analyzing whether a court may exercise general jurisdiction—which was a theory not advanced by Antero—as opposed to specific jurisdiction, and the court noted that such factors are not dispositive in a minimum contacts analysis.

The court of appeals next addressed Antero’s argument that jurisdiction could be exercised over EnerQuest based on its entering into an agreement with Braxton Minerals Appalachia, LLC (“BMA”), a Texas LLC, to form Braxton Minerals III, LLC (“BMIII”), a Delaware LLC with its principal place of business in Texas. The court acknowledged that EnerQuest contracted with a Texas resident by entering into the LLC formation agreement with BMA, but the court emphasized that the agreement forming BMIII was governed by Delaware law, contained an Oklahoma forum selection clause, and specified that the LLC was formed to develop oil and gas business in three states other than Texas. The court characterized these features as showing that EnerQuest “purposefully avoided” Texas. To the extent Antero argued that BMA’s serving as BMIII’s manager and maintaining a principal place of business in Texas established jurisdiction in Texas, the court stated that such facts were not properly considered in its analysis of specific jurisdiction over EnerQuest because those facts focused on BMA’s and BMIII’s relationships to Texas rather than EnerQuest’s.

Finally, the court of appeals distinguished tort cases relied upon by Antero for the proposition that jurisdiction over EnerQuest was supported by EnerQuest’s commission of a tort in Texas by “reaching out” to Texas to solicit, fund, and acquire alleged trade secrets that were sent from Texas. Antero relied heavily on an email exchange in which EnerQuest’s president requested certain drill schedules and BMIII’s owner responded that he did not have digital copies of these closely guarded and valuable records. The court stated that it was unclear how

the email exchange supported the notion that the tort of misappropriation of trade secrets by acquisition was committed in Texas, noting that there was nothing to show that the email was sent “to Texas” or that the reply or trade secrets were received in Texas. In fact, the affidavit of EnerQuest’s president stated that he received the reply in Oklahoma. Furthermore, the court questioned the premise that an email can be sent to a particular state, noting that emails are not sent to a designated computer or electronic device located at a particular place. Emails are transmitted through cyberspace, saved onto a server (or multiple servers), and retrieved wherever the recipient happens to be at the time. “Arguably, to purposely direct an e-mail to a particular state, a sender would be required to know, at the very least, where the recipient’s server is located or where the recipient will be when he or she opens the e-mail. The record here reveals no facts upon which we could conclude that any email was ‘sent to Texas,’ if indeed it would be theoretically possible to do so.” Thus, the court distinguished cases involving torts such as legal and medical malpractice and tortious interference with a business contract, and the court rejected Antero’s argument that the email exchange constituted “reaching into Texas” to acquire trade secrets and purposeful avilment of the benefits and protections of Texas law. In sum, EnerQuest’s contacts lacked a substantial connection to Texas and were too attenuated to the disputed acts allegedly committed in Texas to establish personal jurisdiction over EnerQuest.

*City of White Settlement v. Emmons*, No. 02-17-00358-CV, 2018 WL 4625823 (Tex. App.—Fort Worth Sept. 27, 2018, pet. filed) (mem. op.).

The court of appeals reversed the trial court’s special appearance order as to all claims against Source Capital, LLC (“Source Capital”) and as to the claims for fraud and negligent misrepresentation against Benjamin Emmons. With respect to the claims against Emmons for breach of contract, promissory estoppel, conversion, and violations of the Texas Theft Liability Act (“TTLA”), the court affirmed the special appearance.

The City of White Settlement, Texas (“City”) and the White Settlement Economic Development Corporation (collectively the “City Claimants”) appealed the trial court’s interlocutory order granting the special appearance of Benjamin Emmons and Source Capital, LLC.

The City Claimants entered into a transaction with Hawaiian Parks-White Settlement, LLC (“HPARKS”) pursuant to which the City would ground lease land to HPARKS to construct a water park and would pay up to \$12.5 million for the construction. HPARKS was a Missouri LLC owned by Horizon Family Holdings, LLC (“Horizon Family”), another Missouri LLC.

To finance the park, Horizon Family borrowed additional monies from the Source Capital Lenders. The Source Capital Lenders were affiliates of Source Capital, a Georgia LLC, and they made debt investments in other companies. Emmons, a Georgia resident, was a partner in Source Capital and its managing director. He negotiated the Source Capital Lenders’ loan to Horizon Family.

Horizon Family ran out of money before construction of the park was completed. As a result, HPARKS failed to make its lease payment to the City. The City was prepared to declare a default, but Emmons requested that the City not exercise its rights and work with Source Capital to reorganize the financial obligations of Horizon Family and its subsidiaries. Emmons communicated with the City Claimants about the proposed debt reorganization via email and phone for several months, and Emmons attended a meeting at the City’s offices to discuss the issue. Based on Emmons’s representations, the City agreed not to declare a default.

Ultimately, HPARKS failed to make good on its obligations to the City. The City Claimants sued HPARKS, Emmons, and Source Capital for fraud, negligent misrepresentation, breach of contract, promissory estoppel, conversion, and TTLA violations. Emmons and Source Capital (the “Source Capital Defendants”) filed a special appearance, which the trial court granted.

The court of appeals discussed the law of personal jurisdiction, along with the special appearance evidence, in great detail. With respect to the fraud and negligent misrepresentation claims, the court noted that a nonresident who, while physically present in the State of Texas, makes statements alleged to be fraudulent is subject to specific jurisdiction in Texas in a subsequent action arising from the statement. Additionally, a corporate representative’s contacts undertaken on behalf of an entity are imputed to the entity for jurisdictional purposes. Thus, the court concluded that Emmons’s contacts with Texas may be imputed to Source Capital.

Nevertheless, the court stated that activity is sufficient to establish specific jurisdiction only if it creates a substantial connection with the forum state. The relationship must arise from the purposeful contacts created with the state rather than with a state resident. Mere injury to a forum resident is not a sufficient connection to the forum

state. Specific jurisdiction exists only if the alleged liability arises out of or is related to the defendant's activity within the forum. The court then observed:

The evidence shows that Emmons was physically present at a meeting in Texas with the City Claimants at which he admits discussing the October 1, 2015 ground lease payment as well as the Source Capital-related investment in Horizon Family. This single contact did not create a substantial relationship with only a Texas resident. The Source Capital Defendants' primary focus in the Horizon Family debt restructuring was to protect the Source Capital Lenders' lien position that was at that time secured by assets in a Texas real property interest. . . .

Further, the focus of the Source Capital Lenders' investment in Horizon Family was the construction and operation—through wholly-owned affiliates—of water parks located throughout Texas . . . . The evidence shows that Emmons was the driving force in negotiating and completing the debt reorganization of Horizon Family on behalf of Source Capital and the Source Capital Lenders, from whom he received compensation for managing the Texas-focused investment. And the income from operating the parks on real estate in Texas is what generated return on the investment. Therefore, applying the appropriate standard of review, we hold that the record shows that Source Capital purposefully availed itself of the privilege of conducting business and investment activity in Texas sufficient to confer specific jurisdiction on the trial court over the City Claimants' fraud and negligent misrepresentation claims.

Emmons argued that none of his contacts with Texas may be used to establish jurisdiction over him because he undertook all of them in his representative capacity as managing director of Source Capital. The court disagreed: "But even if all of a corporate representative's actions are performed in his corporate capacity, the officer or member may also be subjected to personal jurisdiction and held liable in his individual capacity for those actions if they were tortious. A corporate officer who had 'direct, personal participation in the wrongdoing' so that he was the 'guiding spirit behind the wrongful conduct' or the 'central figure' in the challenged corporate activity may not escape liability."

Emmons claimed that this individual-tort-liability exception did not apply because the City Claimants merely recast their breach-of-contract claims against HPARKS as tort claims against him. Once again, the court disagreed:

But although the City Claimants' tort claims are related to their contract with HPARKS, they did not plead that the Source Capital Defendants simply assured them that HPARKS would perform its contractual obligations. Instead, the City Claimants contend that the Source Capital Defendants induced them to give a consent under the HPARKS contract that they otherwise had a right to withhold if they had reasonable grounds to do so because the Source Capital Defendants misrepresented their intention to continue operating the Park. Thus, the City Claimants' tort allegations are not simply a recasting of their breach of contract allegations against HPARKS. We therefore hold that the record supports the conclusion that Emmons individually purposefully availed himself of the privilege of conducting activity in Texas sufficient to confer specific jurisdiction over him with regard to the City Claimants' fraud and negligent misrepresentation claims.

With respect to the City Claimants' actions for breach of contract and promissory estoppel, the court observed:

We hold that Source Capital's alleged actions in negotiating a contract with, or making promises to, Texas entities while physically present in Texas and in telephone and email communications thereafter, concerning the investment in, liens on, and continued operation of a waterpark on Texas real property—which alleged contract required the Texas resident to forgo remedies and to take actions directly affecting its Texas real property subject to a ground lease and pursuant to which Source Capital made payments to a Texas municipality—constituted purposeful availment sufficient to confer specific jurisdiction. . . .

But although the City Claimants pleaded that Emmons breached the same contract and made the same promises on behalf of Source Capital, they did not allege that he had any individual contacts related to the breach of contract and promissory estoppel claims. The City Claimants expressly pleaded that these particular claims arose from promises Emmons made in his representative capacity as Source Capital's agent. They did not allege that Emmons was a party to the alleged Workout Agreement or that he made promises to undertake any activity individually in relation to the Workout Agreement. Additionally, the City Claimants did not plead any theory under which Emmons could be held personally liable for breaching Source Capital's alleged obligations under the Workout Agreement or related promises. Unlike in a tort context, a corporate agent who is not individually a party to a contract may not be held liable for breaching a contract to which only his principal is a party. Because specific jurisdiction exists only if the alleged liability arises out of or is related to the defendant's activity within the forum, and as to the breach of contract and promissory estoppel claims the City Claimants do not allege that Emmons entered into a contract with them or made promises in his individual capacity, we hold that the evidence does not support the exercise of specific jurisdiction over Emmons with respect to these two claims.

The City Claimants' actions for conversion and TTLA violations were brought only against Emmons. With respect to those claims, the court noted:

Unlike the fraud and negligent misrepresentation claims, there is no evidence that these claims arise out of a tort Emmons committed while physically present in Texas. And although the ownership of the games [arcade games that were allegedly improperly sold by HPARKS] arises under the terms of the ground lease, the effect of the loss of income from the sale of those games is primarily to the City financially and does not substantially impact the real property subject to the ground lease. Thus, the City Claimants' allegations amount to no more than that Emmons directed a tort at a Texas resident rather than at the State. We hold that the trial court did not err by concluding that Emmons did not purposefully avail himself of the benefits and protections of Texas law for purposes of the City Claimants' TTLA-violation and conversion claims when he stated in an email . . . that the arcade games should be sold.

Finally, with respect to fair play and substantial justice, the court concluded: "Balancing the relatively inconsequential burden to the Source Capital Defendants in traveling to and defending a suit in Texas against (1) Texas's strong interest in adjudicating a dispute involving investments in real-property related interests involving a Texas municipality, which would obtain the most convenient and effective relief in Texas, (2) the fact that torts against the municipality and related economic development corporation were allegedly committed in Texas, and (3) the fact that the most efficient resolution for the judicial system as a whole would be in Texas, we hold that the Source Capital Defendants failed to present a compelling case that it would be unreasonable for a Texas court to exercise jurisdiction over them."

*Momentum Engineering, LLC v. Tabler*, No. 14-18-00002-CV, 2018 WL 4037411 (Tex. App.—Houston [14th Dist.] Aug. 23, 2018, pet. filed).

The court distinguished the issue of personal jurisdiction from that of diversity jurisdiction, concluding that "the citizenship of a limited liability company's members is not a factor to be considered [for purposes of personal jurisdiction], for when evaluating personal jurisdiction, we consider only the defendant's contacts, and a limited liability company is a distinct legal entity from its members." The court also rejected an attempt to impute the Texas contacts of the LLC's managing director and his wife to the LLC based on the veil-piercing theories of alter ego, sham to perpetrate a fraud, and means to evade a legal obligation, explaining:

These claims fall within an exception to the general rule that the party contesting jurisdiction bears the burden to negate the jurisdictional allegations against it. Because the law presumes that a limited liability company is a distinct legal entity, a party wishing to impute

another's jurisdictional contacts to the company bears the burden to prove the alleged bases for doing so.

As a factual basis for disregarding the company's separate nature, Tabler alleged that the Larsens siphoned off corporate assets to avoid corporate debt, then formed new entities to conduct the same business. He claimed that the company's property and the Larsens' individual property were not kept separate; that the Larsens exercised financial control over Momentum; that they commingled funds; that they diverted company profits for their personal use; that they represented they would provide financial backing to the company; that the company was inadequately capitalized; and that the money Momentum borrowed was used to pay the Larsens' personal debts.

Tabler produced no evidence in support of any of these allegations. Because he failed to meet his burden regarding his claims of alter ego, sham to perpetrate a fraud, and evasion of the Larsens' legal obligations, the Larsens' Texas contacts cannot be imputed to Momentum.

***Ball Up, LLC v. Strategic Partners Corp.***, No. 02-17-00197-CV, No. 02-17-00198-CV, 2018 WL 3673044 (Tex. App.—Fort Worth Aug. 2, 2018, no pet.) (mem. op.).

The court of appeals affirmed the trial court's orders granting the special appearances of an individual, a Delaware LLC, and a Delaware limited partnership, and reversed the trial court's denial of a Delaware corporation's special appearance.

Ball Up, LLC (Texas LLC) sued various defendants for misrepresentation and conspiracy: Mike Singer individually (CEO of Strategic Distribution, LP); Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC. These three entity defendants made general appearances. Ball Up also named as defendants Strategic Partners Corp. (Delaware corporation); PG-ACP Holdings, L.P. (Delaware limited partnership); PG-ACP Holdings GP, LLC (Delaware LLC); and Strategic Partners Acquisition Corp. (Delaware corporation) ("SPAC"). After a hearing, the trial court signed orders and amended orders sustaining special appearances filed by Singer individually and the Appellee Entities—Strategic Partners Corp.; PG-ACP Holdings, L.P.; and PG-ACP Holdings GP, LLC. The trial court denied the special appearance filed by SPAC. The court of appeals referred to the generally appearing defendants, the Appellee Entities, and SPAC collectively as the "SP Companies."

On appeal, Ball Up challenged the trial court's orders sustaining the special appearances of Singer and the Appellee Entities. SPAC similarly challenged the denial of its special appearance. Ball Up's challenge was based in part on an argument that the Texas contacts of some of the generally appearing defendants could be imputed to Singer, the Appellee Entities, and SPAC on piercing grounds. In discussing the law of personal jurisdiction based on a piercing theory, the court of appeals observed:

Concerning allegations of personal jurisdiction over a defendant based on the alter-ego theory, personal jurisdiction may exist over a nonresident defendant if the relationship between the foreign corporation and its parent corporation that does business in Texas is one that would allow the court to impute the parent corporation's "doing business" to the subsidiary. *BMC Software Belg., N.V.*, 83 S.W.3d at 798–99. The rationale for exercising alter-ego personal jurisdiction is that "the parent corporation exerts such domination and control over its subsidiary 'that they do not in reality constitute separate and distinct corporate entities but are one and the same corporation for purposes of jurisdiction.'" *Id.* (quoting *Hargrave v. Fibreboard Corp.*, 710 F.2d 1154, 1159 (5th Cir. 1983)). The party seeking to ascribe one corporation's actions to another by disregarding their distinct corporate entities must prove this allegation because Texas law presumes that two separate corporations are indeed distinct entities. *Id.*

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 and that the degree of control the parent exercises is 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 proof required of a party seeking to fuse a parent company and a subsidiary company for jurisdictional veil-piercing purposes is different and more strenuous than the proof required of a party seeking to fuse a parent and a subsidiary company for substantive veil-piercing purposes. . . .



Because Texas law presumes that two separate corporations are distinct entities, Ball Up, as the party seeking to ascribe the actions of some of the SP Companies to other of the SP Companies for jurisdictional purposes by piercing the corporate veil, bore the burden of proving an alter-ego relationship. Absent proof by Ball Up establishing a factual basis for some legal theory, such as alter-ego or single-business enterprise, to attain corporate veil piercing that will support the aggregation of acts or contacts by separate legal entities, they will not be aggregated. That is, Ball Up's pleadings and briefing relating to acts performed by and contacts with the SP Companies (assuming the facts pleaded such contacts and acts occurred in Texas) is nonetheless not sufficient to establish general-jurisdiction minimum contacts or specific committed-a-tort-in-whole-or-in-part-in-Texas jurisdiction unless the acts and contacts Ball Up has attributed to the SP Companies are attributable to one or more of the Appellee Entities, to SPAC, or to Singer under an alter-ego/veil-piercing theory.

The court of appeals ultimately concluded that Ball Up failed to meet its burden of establishing its piercing allegations for jurisdictional purposes:

On appeal, Ball Up does not focus on the purported alter-ego relationship existing between any particular SP Companies or Singer. Instead, Ball Up argues that personal jurisdiction exists under the alter-ego/veil-piercing theory because the SP Companies "cannot prove which company(ies) made the decisions on the Ball Up project, they cannot prove which company(ies) did not make the decisions on the Ball Up Project" and that, therefore, "none of these entities can negate Ball Up's allegations that they were involved in the project." But Ball Up—not the Appellee Entities, SPAC, or Singer—had the burden of pleading and proving an alter-ego/veil-piercing theory in order to attribute contacts with the forum by one defendant to another defendant or to attribute jurisdictional acts by one defendant to another defendant.

Ball Up had the burden to overcome the presumption that two separate business entities are distinct by proving its alter-ego/veil-piercing allegation. To fuse all of the SP Companies for jurisdictional purposes—that is, to make the acts or contacts of the generally-appearing defendants Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC or of other specially-appearing defendants constitute acts or contacts by the Appellee Entities, SPAC, or Singer—Ball Up was required to establish that the Appellee Entities, SPAC, or Singer exercised a degree of control over Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners, LLC that is "greater than that normally associated with common ownership and directorship"; the evidence must show that the Appellee Entities, SPAC, Singer, and the generally-appearing defendants or some combination of these ceased to be separate.

The following factors have been identified as important to determining whether a subsidiary is separate and distinct from its parent corporation for personal jurisdiction purposes: (1) the amount of the subsidiary's stock owned by the parent corporation, (2) the existence of separate headquarters, (3) the observance of corporate formalities, and (4) the degree of the parent's control over the general policy and administration of the subsidiary. The types of evidence a court will consider as proof of alter ego—when a person is alleged to be the alter ego of a corporation but also applicable in allegations of entity-to-entity alter ego—include: (1) the payment of alleged corporate debt with personal checks or other commingling of funds; (2) representations that the individual will financially back the corporation; (3) the diversion of company profits to the individual for his personal use; (4) inadequate capitalization; and (5) other failure to keep corporate and personal assets separate.

Ball Up did not offer evidence of financial commingling of funds between any combination of the SP Companies and Singer, the payment of one of the SP Companies' debt by another or by Singer, the diversion of profits from one SP Company to another or to Singer, the failure to keep separate accounting records or corporate books, a lack of separate legal formation, or other evidence that would establish that the Appellee Entities, SPAC, or Singer exercised a degree of control over Strategic Partners, Inc.; Strategic Distribution, LP; and Strategic General Partners,

LLC that is greater than that normally associated with common ownership and directorship so that the Appellee Entities, SPAC, and the generally-appearing defendants ceased to be separate entities.

The evidence Ball Up did produce with regard to SPAC consisted of two spreadsheets containing SPAC's name that were provided to Ball Up and that detailed the Ball Up Apparel Project's expenses. Ball Up argues that these spreadsheets coupled with the alleged failure of the SP Companies to maintain separate and distinct corporate identities is sufficient to support the trial court's denial of SPAC's special appearance. We cannot agree. Even if SPAC created the spreadsheet for the project's current expenses, the two spreadsheets simply represent a calculation of expenses and do not establish any amounts billed by SPAC or work performed by SPAC. Thus, the spreadsheets are insufficient to support a showing that SPAC has the minimum contacts necessary to demonstrate that the trial court has personal jurisdiction over SPAC.

The evidence Ball Up did produce with regard to the Appellee Entities consisted of excerpts from [Robert] Pierpoint's deposition [an officer of various SP Companies] establishing that the composition of the board of directors of each of the SP Companies was the same or substantially the same; that Padraic McConville worked for Partners Group; that Partners Group was a private equity partner that sat on the board of directors for PG-ACP Holdings, GP; and that McConville put Ball Up proposal numbers together for the PG-ACP Holdings, GP's board of directors. Ball Up's evidence and contentions, however, do not rise to the required level of control and domination by one or more of the SP Companies over one or more of the other SP Companies necessary to meet Ball Up's burden of proving that the SP Companies ceased to be separate entities and are one and the same for jurisdictional purposes. [Ball Up does not specifically identify which of the generally-appearing defendants, the Appellee Entities, or SPAC are purportedly fused for jurisdictional purposes; Ball Up alleges all of them were intertwined and acted jointly.]

Ball Up's alter-ego/veil-piercing jurisdictional evidence at most shows some common ownership between the SP Companies and some common and overlapping boards of directors; this type of evidence does not establish alter ego for jurisdictional purposes. [If Ball Up had met its burden of proving alter ego, no evidence exists that piercing the corporate veil of any particular entity or entities for purposes of personal jurisdiction is necessary to prevent fraud or injustice.]

Because Ball Up failed to assert or to offer proof of acts by the Appellee Entities, SPAC, and Singer in furtherance of Ball Up's tort claims against them and also failed to meet its burden of proving its alter-ego/veil-piercing jurisdictional theory concerning the Appellee Entities, SPAC, and Singer, the trial court properly sustained the Appellee Entities' and Singer's special appearances and erred by denying SPAC's special appearance.

The court also observed: "In addition to factually negating personal jurisdiction, Singer's affidavit and special-appearance evidence legally negated personal jurisdiction; Singer established that at all times in any dealings with Ball Up he was acting in his corporate capacity on behalf of generally-appearing Strategic Distribution. Thus, even if Singer had contacts with Texas or performed acts in Texas—which he directly denied in his affidavit—personal jurisdiction over him could not be predicated on jurisdiction over Strategic Distribution unless Strategic Distribution is the alter ego of Singer."

*DeVries v. Bulldog Well Testing LLC*, Civil Action No. 7:16-CV-00338, 2017 WL 1134318 (S.D. Tex. Mar. 27, 2017). (Although the court issued this opinion in 2017, it is included in this year's update because it did not appear in the Westlaw database until recently.)

The court rejected the plaintiff's attempt to impute the contacts of Gary Unterbrink, who allegedly managed an LLC's day-to-day business operations, to the three individual members of the LLC. In response to the plaintiff's attempt to invoke the "single business enterprise" doctrine, the court explained:

Plaintiffs attempt to rectify their insufficient allegations and evidence by imputing any of Unterbrink's jurisdictional conduct onto Defendants.[footnote omitted] To support this contention, Plaintiffs cite a single Texas Supreme Court case from 2007 which discusses the "single business enterprise" theory.[footnote omitted] According to this theory, jurisdictional conduct of a corporate subsidiary may be imputed to the parent corporation.[footnote omitted] Plaintiffs contend that

Unterbrink counts as Defendants’ “subsidiary,” and thus his actions may be imputed to Defendants.[footnote omitted]

Plaintiffs’ argument fails. The case Plaintiffs cite specifically states that the Texas Supreme Court has not endorsed the single business enterprise doctrine: “Here, the court of appeals held that Province and Minden operated as a single business enterprise—a theory we have never endorsed—and, therefore, Province’s Texas contacts could be imputed to Minden.”[footnote omitted] Indeed, one year later, the Texas Supreme Court expressly abrogated the single business enterprise doctrine.[footnote omitted] Even so, the Court observes a veritable chasm between Plaintiffs’ legal theory—which applies to corporations and their subsidiaries—and the facts of this case, which involve LLC members and a manager they hired. By default, LLC members are not themselves a corporate entity, and even if they were, Unterbrink is not a corporate “subsidiary” in any meaningful sense of the word.[footnote omitted]

***Ramirez v. Chenega Corporation***, EP-06-CA-0208-DB, 2006 WL 8434037 (W.D. Tex. Nov. 16, 2006). (Although the court issued this opinion in 2016, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court analyzed whether the record supported exercising personal jurisdiction over a corporation (Chenega Corporation or “Chenega”) that was the 51% member of an LLC (Chenega Integrated Systems, L.L.C. or “CIS”) based on an alter-ego relationship between Chenega and CIS. The court based its analysis on seven factors enumerated by the Fifth Circuit to determine whether a parent corporation can be held amenable to personal jurisdiction based on the acts of a subsidiary company, and the court concluded that the record did not show the requisite level of control over the day-to-day business of the subsidiary. “While the facts show Chenega exercises some degree of control over CIS, the same evidence tends to show that it was routine guidance associated with normal parent-subsidiary ownership and directorship. Chenega and CIS have maintained a degree of corporate separation that is more than superficial. . . . Nothing was presented to show a degree of control that rises to the level required by the Fifth Circuit, the degree of control required to ‘fuse the two [Defendants] for jurisdictional purposes.’”

## **W. Service of Process**

***Hockenbergs Equipment and Supply Co., Inc. v. Team Contractors, LLC***, EP-18-CV-346-PRM, 2019 WL 1253576 (W.D. Tex. Mar. 11, 2019).

In the context of a motion for entry of a default judgment and an order setting aside the default judgment, the court discussed whether service of process on the defendant, a Kentucky LLC, was proper. The plaintiff contended that it served the LLC at its principal place of business in Kentucky by serving Henry Doughty, the LLC’s “manager,” but the LLC argued that Doughty was not an individual through whom service on the LLC could be achieved. The court explained that in these circumstances service could be achieved under either Kentucky or Texas law. Under Texas law, each manager of a manager-managed domestic or foreign LLC is an agent for service of process, and each member of a member-managed domestic or foreign LLC is an agent for service of process. Tex. Bus. Orgs. Code § 5.255. The Kentucky Rules of Civil Procedure provide that service on an unincorporated association may be made by serving “an officer or managing agent of the association.” Additionally, Fed. R. Civ. P. 4(h)(1)(B) allows service on an “officer” or a “managing or general agent.” The court discussed information contained in affidavits submitted by the parties, governing documents of the LLC, and records of the Kentucky and Texas Secretaries of State to determine whether the record showed that the LLC could be served by serving Doughty at the time he was served, and the court concluded that the record supported that Doughty was an officer or managing agent of the LLC at the time he was served for purposes of Federal Rule 4. Service was thus proper.

***Westchester Fire Insurance Company v. Saab Contractors, L.P.***, EP-17-CV-00333-DCG, 2018 WL 7283632 (W.D. Tex. Oct. 30, 2018).

The court granted an order for substituted service after the plaintiff’s repeated failed attempts to serve an individual and a limited partnership and LLC of which the individual was registered agent. In the course of discussing the permissible methods of service of process, the court noted that an LLC may be served through its

registered agent or other agents authorized to receive service, such as its managers and members, citing Tex. Bus. Orgs. Code §§ 5.201(a), 5.253(3).

## **X. Pro Se Representation**

***Campanile Investments LLC v. Westmoreland Equity Fund LLC***, SA 17-CV-00337-FB, 2019 WL 1865287 (W.D. Tex. Apr. 25, 2019).

The court held that a single-member LLC could not represent itself without licensed counsel in federal court.

The court was not persuaded by the argument that a single-member LLC should be treated like a sole proprietorship for purposes of the rule regarding *pro se* representation. The court noted that it was aware of no authority that the IRS treatment of a single-member LLC as a disregarded entity for federal tax purposes translates to an ability to disregard the LLC entity for purposes of self representation in federal court. Accordingly, the court declined to set aside a default judgment against the LLC but noted the denial was without prejudice to the LLC retaining licensed counsel to represent it in the action.

***Salsgiver v. Kingdom Guard, LLC***, Civil Action No. 2:18-CV-324, 2018 WL 6804601 (S.D. Tex. Dec. 27, 2018).

The court dismissed counterclaims asserted in a pleading signed by a non-attorney on behalf of two LLC defendants because limited liability companies are “fictional legal persons that can only be represented in court by licensed counsel.”

***Vanderploeg v. Vetus Investments LLC***, Civ. A. No. H-18-2298, 2018 WL 4491371 (S.D. Tex. Sept. 9, 2018) (“Limited liability companies must follow the rule for corporations appearing in federal courts. A corporation is not a natural person and may appear in federal court only if represented by counsel.”).

***Van Winkle v. JSCP, LLC***, Civ. A. No. H-17-1986, 2018 WL 3756963 (S.D. Tex. Aug. 8, 2018) (“The Fifth Circuit has held that corporations are fictional legal persons who can only be represented by licensed counsel. Courts in the Fifth Circuit have held the term ‘corporation’ includes limited liability companies. . . . Because there was never a response to the complaint by a licensed attorney representing Fishtales, it has failed to answer or otherwise defend against this lawsuit.”).

***Mota v. Beacon Bay Asset Management, LLC***, No. 3:17-cv-1862-N-BN, 2018 WL 3626343 (N.D. Tex. June 19, 2018) (“As the Court previously explained, Defendant Beacon Bay Asset Management, LLC is a limited liability company; insofar as it is neither an individual nor a sole proprietorship, this defendant is not permitted to proceed *pro se* or through a non-attorney but rather must be represented by an attorney in litigation in federal court; [t]he ‘clear’ rule is ‘that a corporation as a fictional legal person can only be represented by licensed counsel’; and this applies to limited liability companies.”).

***Direct Energy Marketing Ltd. v. Marii Energy, LLC***, Civil Action No. H-16-1174, 2017 WL 7794358 (S.D. Tex. June 6, 2017). (Although the court issued this opinion in 2017, it is included in this year’s update because it did not appear in the Westlaw database until recently.)

The court referred to the LLC defendants as “corporations” that could not appear in federal court unless properly represented by a licensed attorney. As such, the court struck the answers filed by an individual on their behalf.

## **Y. Venue**

***Westberry v. GusTech Communications, LLC***, Civ. A. No. 3:17-CV-3162-D, 2018 WL 3548869 (N.D. Tex. July 24, 2018) (“Under 28 U.S.C. § 1391(c)(2), a corporate defendant is deemed to ‘reside,’ for venue purposes, in any judicial district in which it is subject to the court’s personal jurisdiction with respect to the civil action in question. ‘[A]lthough the wording of section 1391(c) only appears to apply to corporations, courts have

held and it is generally accepted that unincorporated business associations such as partnerships and limited liability companies are analogous to corporations for venue purposes.’”).

*Seven Networks, LLC v. Google LLC*, 315 F. Supp. 3d 933 (E.D. Tex. 2018) (“As discussed above, venue lies only ‘in the judicial district where the defendant resides, or where the defendant has committed acts of infringement and has a regular and established place of business.’ 28 U.S.C. § 1400(b). Google argues that it meets neither requirement. It is undisputed that when this action was filed, Google was incorporated in Delaware and therefore ‘resided’ in Delaware, not in Texas. SEVEN does not dispute this. Accordingly, Google’s residence cannot provide a basis for venue in this District.”).

*Trilogy Cellars, LLC v. Flora Springs Wine Company*, Civ. A. No. 5:17-CV-029-C, 2017 WL 6816495 (N.D. Tex. July 11, 2017) (Although the court issued this opinion in 2017, it is included in this year’s update because it did not appear in the Westlaw database until recently.) (“For purposes of venue, a defendant that is an unincorporated association, such as a limited liability company, is deemed to reside in any judicial district in which it is subject to personal jurisdiction at the time the action is commenced. 28 U.S.C. § 1391(c).”).

*Henry v. Bush Lewis, PLLC*, Civ. A. H-09-1152, 2009 WL 10693534 (S.D. Tex. July 31, 2009) (Although the court issued this opinion in 2009, it is included in this year’s update because it did not appear in the Westlaw database until recently.) (“Though Bush Lewis PLLC is not a corporation, courts have applied § 1391(c)’s venue provisions for corporations by analogy to unincorporated associations such as LLCs. Thus, for venue purposes, unincorporated associations like Bush Lewis PLLC reside in all districts in which they do business and thereby are subject to personal jurisdiction.”).

## **Z. Governing Law**

*Lion Co-Polymers Holdings, LLC v. Lion Polymers, LLC*, No. 01-16-00848-CV, 2018 WL 3150863 (Tex. App.—Houston [1st Dist.] June 28, 2018, pet. filed) (mem. op.).

In a breach-of-contract action in which the distribution provisions of Delaware LLC’s agreement provided that it “shall be governed by, and construed in accordance with, the Laws of the State of Delaware applicable to contracts made and performed in [that] state, without regard to conflicts of law doctrines,” the court of appeals noted that it would “apply Texas procedural law, and . . . apply Delaware law on the issues of contract construction and interpretation.”

*MCR Oil Tools, LLC v. SPEX Offshore, Ltd.*, Civ. A. No. 3:18-cv-00731-M, 2018 WL 4362695 (N.D. Tex. Sept. 13, 2018).

“The Court notes that the requested business and organizational documents sought by MCR are relevant and discoverable under Texas alter ego law. Presumably, Texas law will govern whether the corporate veil of SPEX Group, a Texas limited liability company, will be pierced. *See* Tex. Bus. Orgs. Code § 1.104; *see also* *Alberto v. Diversified Grp., Inc.*, 55 F.3d 201, 204 (5th Cir. 1995); *Davaco, Inc. v. AZ3, Inc.*, No. 3:07-CV-803, 2008 WL 2243382, at \*1 (N.D. Tex. May 30, 2008) (“[A] choice of law provision in a contract does not alter the rule that the law of the state of incorporation governs the alter ego analysis.”).

## **AA. Fifth Amendment Right Against Self Incrimination**

*In re Natural Gas Consulting & Measurement, LLC*, No.07-18-00309-CV, 2018 WL 7458616 (Tex. App.—Amarillo Oct. 10, 2018, orig. proceeding) (mem. op.).

The court of appeals held that the trial court could compel production of books and records by an LLC via deposition of the LLC’s designated representative and sanction the representative for invoking the Fifth Amendment as a shield against disclosure of the books and records, but the trial court could not prohibit the representative from invoking the Fifth Amendment privilege to the extent oral testimony was sought from the representative that might incriminate the representative.

The plaintiff in the underlying lawsuit sought to depose an LLC and an individual representative, and they invoked the right to refrain from incriminating themselves. The trial court then ordered that the LLC designate a “corporate representative” and indicated that the corporate representative would not be allowed to invoke the right against self-incrimination when being deposed as corporate representative and would be subject to sanctions if he did so. The LLC argued that “[t]here was no absolute rule’ preventing ‘the sole member and only knowledgeable representative of a limited liability company from invoking the Fifth Amendment right against self-compelled incrimination” and that the LLC and its representative should not be forced to choose between asserting their constitutional rights or being subject to sanctions. The court of appeals in this mandamus proceeding relied on case law in the corporate context and *In re Russo* (summarized below) in analyzing and resolving the issues as follows:

A corporation and its human representatives are two distinct entities. Moreover, a corporation, like other “artificial entities” has no right under the Fifth Amendment of the United States Constitution to avoid incriminating itself. *Braswell v. United States*, 487 U.S. 99, 102-103, 108 S.Ct. 2284, 101 L.Ed.2d 98 (1988); *In re Russo*, 550 S.W.3d 782, 788 (Tex. App.—Houston [14th Dist.] 2018, orig. proceeding). This verity has been used to require corporate representatives who are the custodian of corporate records to produce those records even though doing so may tend to incriminate the representative. *In re Russo*, 550 S.W.3d at 788. Yet, it is just as true that the same representative cannot be made to incriminate himself via “his own *oral* testimony.” *Braswell v. United States*, 487 U.S. at 114, 108 S.Ct. 2284 (quoting *Curcio v. United States*, 354 U.S. 118, 77 S.Ct. 1145, 1 L.Ed.2d 1225 (1957) (emphasis added). And, in Texas, no one can deny that a person acting on behalf of a corporation may be held criminally responsible for the conduct taken on behalf of the corporation. See TEX. PENAL CODE ANN. § 7.23(a) (West 2011) (stating that “[a]n individual is criminally responsible for conduct that he performs in the name of or in behalf of a corporation or association to the same extent as if the conduct were performed in his own name or behalf.”); *Ex parte Canady*, 140 S.W.3d 845, 850 (Tex. App.—Houston [14th Dist.] 2004, no pet.) (stating the same). From these, we derive the answer to the question at hand. The trial court may compel a corporate representative to appear for deposition and testify on behalf of the corporation. So too may it order the custodian of corporate books and records to produce same despite the chance that doing so incriminates both the custodian and the corporation. But, the trial court may not compel the representative designated to testify on behalf of the “artificial entity” to provide oral testimony that would incriminate himself.

Thus, the court concluded that the trial court could compel disclosure of books and records sought via a deposition of the LLC’s designated corporate representative and sanction the representative for invoking the Fifth Amendment as a shield against disclosure of the books and records, but the trial court could not prohibit the representative from invoking the Fifth Amendment privilege to the extent oral testimony was sought from the representative that might incriminate the representative. To the extent the trial court’s order was a blanket prohibition on assertion of the Fifth Amendment privilege at the risk of sanctions, the order was an abuse of discretion.

*In re Russo*, 550 S.W.3d 782 (Tex. App.—Houston [14th Dist.] 2018, orig. proceeding).

The court of appeals held that an individual member of an LLC could not rely on the Fifth Amendment privilege against self-incrimination to avoid producing documents sought in a discovery request in the underlying proceeding, even if the act of production incriminated the individual, because there was evidence the documents were records of the LLC, and an artificial entity has no right against self-incrimination.

The plaintiff in the underlying proceeding served requests for production of documents on the controlling member of numerous LLCs, Christopher Russo, and Russo attempted to invoke the act-of-production privilege against self-incrimination under the Fifth Amendment. The trial court ordered Russo to produce the documents, and Russo sought to compel the trial court to vacate the order in this mandamus proceeding. The court of appeals denied the writ of mandamus because artificial entities are not protected by the Fifth Amendment, and an individual is not permitted to invoke the Fifth Amendment privilege to avoid producing records of an entity even if the records might incriminate the individual personally. Russo argued that the documents at issue, which consisted mostly of email communications, were not records of any of his LLCs, but rather were personal records. The court concluded that

the evidence indicated that the emails were likely records of an LLC because they were sent or received by Russo as an agent of an LLC in the course of its business. Further, there was evidence that the Yahoo email account was used by Russo to conduct business of his LLCs. To invoke the privilege and avoid production, Russo had the burden to prove that the withheld documents were personal and not records of his entities, and Russo failed to meet that burden.