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"Amendments" - The Most Important Provision in the Company or Partnership Agreement

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Contents

1. Introduction.

This paper discusses the drafting and use of the "Amendments"[1] provision in partnership and company agreements[2] (collectively, "Agreements"). It discusses provisions providing for amendment by fewer than all of the partnership's partners or LLC's members (collectively, "Owners"), including questions of amendments which adversely affect Owners in a unique way, effects of amendments on former Owners, and the ability of amendments to ratify past actions.

2. Why is the Amendments Provision Important?

The Agreement represents the fundamental deal among the Owners.[3] As such, the ability to amend the Agreement is the equivalent of the ability to change the deal itself. Consideration

[1] For an excellent article on this topic see, Rutledge and Sagan, An Amendment Too Far? Limits on the Ability of Less Than All Members to Amend the Operating Agreement, 16 Fla. St. U. Bus. Rev. 1 (Spring 2017).

[2] Tex. Bus. Org. Code § 101.001(1) uses the term "Company agreement" to describe the members' agreement with respect to the LLC, most other statutes use the term "operating agreement" and some use "limited liability company agreement" to describe this agreement. In this outline, this agreement will be referred to as a "company agreement' or "operating agreement".

[3] Larry Ribstein and Robert Keatinge, Ribstein and Keatinge on Limited Liability Companies § 4:16 (June 2018) ("Ribstein and Keatinge") ("The operating agreement provides most of the terms of the parties' agreement relating to such important matters as capitalization, distributions, admission and withdrawal of members, management, fiduciary duties, and dissolution. Thus it has been said that, because of the parties' broad power to vary statutory defaults in the operating agreement, 'an LLC is primarily a creature of contract.'"), Bishop and Kleinberger, ¶

of an Owner's rights and duties under an Agreement should always include a review of the amendment provisions. If an owner (the "Controlling Owner") has the authority to unilaterally amend the Agreement, the Controlling Owner not only has the ability to resolve issues that arise in the operation of the organization but may have the ability to make changes in the Agreement that may eliminate the rights and other benefits for which the other Owners ("Non-Controlling Owners") have negotiated and on which they may rely. Thus, particularly with respect to issues that are important to them, Non-Controlling Owners should make sure to have negotiated protections allowing them to block amendments that might eliminate important rights and benefits. Where is there more than one non-conforming member, it might be appropriate to provide a blocking right with respect to important provisions to a majority of the similarly interested Non-Controlling Owners as a balance between the power of the Controlling Owner and the right of a single Non-Controlling Owner to block an amendment. The sorts of rights and benefits that may be significant to a Non-Controlling Owner may be as broad as the purpose of organization or as narrow as office policies and will generally include any unique economic arrangement that the non-economic Owner has with the organization.

3. **Initial Agreement.**

While the statutes vary among forms of organization and from state to state as to whether the Agreement need be in writing, they are generally unanimous that the initial Agreement must be the Agreement of all of the Owners. Texas statutes do not require that the partnership,[4] or company[5] Agreement be in writing and generally provide that the initial Agreement be the Agreement of Owners (i.e., the agreement of all the members or partners). In addition, as a result of the informality of the Agreement under the Texas statutes and most other state statutes, most any agreement among all the Owners as to the operation of the organization and the relationship among the Owners and assignees will constitute an Agreement. With a few exceptions, the partnership[6] or company[7] Agreement supplants the provisions of the TBOC with respect to the relationships among the Owners, assignees, and the organization. The Texas courts have

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5.06[1][a] ("One court has referred to the operating agreement as the "heart and soul of an LLC" and another has used the word 'cornerstone.'"); R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC, No. CIV.A. 3803-CC, 2008 WL 3846318, at *1 (Del. Ch. Aug. 19, 2008) (in which Chancellor Chandler stated, "For Shakespeare, it may have been the play, but for a Delaware limited liability company, *the contract's the thing*. Ultimately, it is the contract that compels the Court's decision in this case because it is the contract that "defines the scope, structure, and personality of limited liability companies." [citations omitted, emphasis in the original]); Fisk Ventures, LLC v. Segal, No. CIV.A. 3017-CC, 2009 WL 73957, at *2–3 (Del. Ch. Jan. 13, 2009), aff'd, 984 A.2d 124 (Del. 2009) ("'Limited Liability Companies are creatures of contract, "designed to afford the maximum amount of freedom of contract, private ordering and flexibility to the parties involved." Delaware's LLC Act thus allows LLC members to 'arrange a manager/investor governance relationship;' the LLC Act provides defaults that can be modified by contract" as deemed appropriate by the LLC's managing members. The LLC Act explicitly states that '[i]t 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.'" (citations omitted.).

[4] Tex. Bus. Org. Code § 151.001(5) ("'Partnership agreement' means any agreement, written or oral, of the partners concerning a partnership.").

[5] Tex. Bus. Org. Code § 101.001(1) ("'Company agreement' means any agreement, written or oral, of the members concerning the affairs or the conduct of the business of a limited liability company."). For a chart comparing state statutes on this issue, see Ribstein and Keatinge Appendix 4:19.

[6] Tex. Bus. Org. Code § Sec. 154.001(d).

[7] Tex. Bus. Org. Code § 101.106.

consistently construed and interpreted Agreements pursuant to the applicable law of contracts,[8] but have also noted that the statutes under which organizations are formed may vary contract law.[9] The interpretation of Agreements in general and provisions related to amendments may be informed by two contractual concepts: Texas' strong public policy in favor of preserving the freedom of contract,[10] and the limitation in Texas of the duty of good faith and fair dealing to "special relationships" such that of an insured and an insurer.[11] Taken together, these concepts should support the enforceability of the amendment provisions in an Agreement.[12]

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[8] See Park Cities Corp. v. Byrd, 534 S.W.2d 668, 672 (Tex.1976); Murphy v. Seabarge, Ltd., 868 S.W.2d 929, 933 (Tex.App.-Houston [14th Dist.] 1994, writ denied).

[9] the courts have consistently applied contractual principles to the interpretation of agreements, but also notes that the statutes under which organizations are formed may vary contract law. See, Aztec Petroleum Corp. v. MHM Co., 703 S.W.2d 290, 293-294 (1985) holding:

> For the purposes of this opinion, we assume, but do not decide, that Aztec is correct in its assertion that contract law requires the unanimous consent of all parties to the contract before the fundamental nature of the contract may be changed. The partnership act, however, provides for alteration of this concept. Section 18(1) provides: "The rights and duties of partners in relation to the partnership shall be determined, subject to any agreement between them, by the following rules...." Article 6132b, § 18(1) (emphasis added). The partnership agreement in the present case specifically provides for the amendment of the agreement by less than a unanimous vote of the parties. We conclude, therefore, that any unanimity which may be required by contract law was met when all parties to the partnership agreement consented to be bound by amendments passed by "the holders of seventy percent (70%) or more of the Units."

[10] Many statutes (roughly half of the LLC statutes) include an express provision to the effect that it is the policy of the statute to give maximum effect to the principle of freedom of contract. Texas Courts have generally See Ribstein and Keatinge Appendix 9-8 for a listing. The Texas statutes do not have such a statutory provision, but Texas courts have generally supported the concept of freedom of contract. El Paso Field Servs., L.P. v. MasTec N. Am., Inc., 389 S.W.3d 802, 811–12 (Tex. 2012). ("We have 'long recognized Texas' strong public policy in favor of preserving the freedom of contract.' ... 'Freedom of contract allows parties to ... allocate risk as they see fit.' ").

[11] See, e.g., Natividad v. Alexsis, Inc., 875 S.W.2d 695, 697–98 (Tex. 1994) (citing Arnold v. National County Mutual Fire Insurance Company, 725 S.W.2d 165 (Tex.1987) and stating, "The duty of good faith and fair dealing emanates from the special relationship between the parties and not from the terms of the contract, therefore its breach gives rise to tort damages and not simply to contractual liability. However, the "special relationship" exists only because the insured and the insurer are parties to a contract that is the result of unequal bargaining power, and by its nature allows unscrupulous insurers to take advantage of their insureds. Without such a contract there would be no "special relationship" and hence, no duty of good faith and fair dealing." citations omitted.).

[12] See, Allen v. Devon Energy Holdings, LLC, 367 S.W.3d 355, 391 (Tex. App.–Houston [1st Dist] 2012, pet. granted, judgm't vacated, w.r.m.) (holding that as a result of the similarities between an LLC and a partnership the manager-owner of an LLC owed a fiduciary duty to the non-participating minority owner) and B Choice Ltd. v. Epicentre Dev. Assocs., LLC, No. CV H-14-2096, 2017 WL 1227313, at *16 (S.D. Tex. Mar. 3, 2017), report and recommendation adopted, No. CV H-14-2096, 2017 WL 1160512 (S.D. Tex. Mar. 29, 2017) (citing Entertainment Allen and Mechandising Technology, LLC v. Houchin, 720 F. Supp.2d 792, 797 (N.D. Tex. 2010) in holding "While it is true that "[n]o Texas court has held that fiduciary duties exist between members of a limited liability company as a matter of law" and that Texas does not "recognize[ ] a broad formal fiduciary relationship between majority shareholders in closely-held companies that would apply to every transaction among them," Texas courts have recognized a fiduciary relationship in the context of LLCs, stating that the recognition of such a fiduciary relationship is "typically a question of fact."). Note that Tex. Bus. Org. Code § 152.204(b) does require the general partner to "discharge the partner's duties to the partnership and the other partners under this code or under the partnership agreement and exercise any rights and powers in the conduct or winding up of the partnership business: (1) in good faith; and(2) in a manner the partner reasonably believes to be in the best interest of the partnership." This contrasts with Tex. Bus. Org. Code § 152.204(a) under which a general partner owes duties of loyalty and care

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