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

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

Elizabeth S. Miller

I. Introduction

This paper summarizes recent Texas cases involving issues of partnership and limited liability company law. Summaries of cases involving general and limited partnerships are provided for the current calendar year and the previous three calendar years. Because limited liability companies and limited liability partnerships are a relatively recent innovation in the law and the body of case law is more limited, summaries of cases involving these types of entities are provided for the time frame from the inception of the case law on these entities in Texas.

II. Recent Texas Cases Involving General Partnerships

A. Existence of Partnership

Advanced Nano Coatings, Incorporated v. Hanafin, No. 10-20865, 2012 WL 1957895 (5th Cir. May 31, 2012).

Three entities sued a chemist, Joseph Hanafin, for breach of contract, breach of fiduciary duties, and tortious interference with a prospective contract. One of the plaintiffs was Intumescents Associates Group (IAG), a partnership allegedly formed by Hanafin, Hugh Scott, and Craig Scott to market any future technology Hanafin might develop. The district court ruled that the IAG partnership was never formalized and lacked the legal capacity to bring this suit. The court of appeals noted that the Texas Business Organizations Code provides that an association of two or more persons to carry on a business for profit as owners creates a partnership regardless of whether the persons intend to create a partnership or whether the association is called a "partnership," "joint venture," or other name. The court also noted that the Texas Business and Commerce Code prohibits persons doing business under an assumed name from maintaining in a Texas court an action arising out of a contract or act in which an assumed name was used until an assumed name certificate has been filed as required by the statute. IAG did not file an assumed name certificate until two weeks prior to the scheduled trial date. The certificate identified IAG as a partnership owned by Craig and Hugh Scott, and the district court recognized that it is possible for a partnership to cure lack of capacity by belatedly filing a certificate. However, the district court ruled that IAG could not cure the defect because it did not exist as a partnership at that time or when the complaint was filed. The court of appeals concluded that the district court erred in ruling there was no issue of material fact with respect to the existence of IAG as a partnership. The court of appeals relied on the five statutory factors considered in determining the existence of a partnership: (1) the receipt or right to receive a share of profits of the business; (2) the expression of an intent to be partners in the business; (3) participation or the right to participate in control of the business; (4) an agreement to share or sharing in the losses of the business or liability for claims by third parties against the business; and (5) an agreement to contribute or contributing money or property to the business. With respect to the first factor, Hugh Scott testified in a deposition that Hanafin had a 25% interest in the IAG partnership, indicating that Hanafin had a right to receive a share of the profits. With respect to the second factor, Hanafin testified in his deposition that he, Hugh Scott, and Craig Scott "formed a partnership, IAG." He also testified that he did work on behalf of IAG under a nondisclosure agreement and signed a confidentiality agreement as IAG's Director of Technology Development. Regarding the third factor, Hanfin dealt directly with other companies on behalf of IAG in that he had authority to sign agreements on IAG's behalf. Although there was no apparent agreement that Hanafin was required to share in IAG's losses, the court noted that the statute expressly provides that an agreement by the owners of a business to share losses is not required to create a partnership. As for the fifth factor, Hanafin's creation of formulas and product would constitute a contribution of property to the business. Since four of the five factors indicated the creation of a partnership, the court concluded that the district court erred in ruling that there was no issue of material fact as to the existence of IAG as a partnership.

Shavers v. Sunbelt Equipment Marketing, Inc., No. 10-11-00330-CV, 2012 WL 1871605 (Tex. App.–Waco May 23, 2012, no pet. h.).

The plaintiff sued Jerry Edwards and Jens Lorenz in their individual capacities and doing business as Jesco Disaster Services. Lorenz filed a general denial, but Edwards did not answer. In an amended petition, the plaintiff added John Shavers and alleged that Lorenz, Edwards, and Shavers participated in a partnership of Jesco Disaster Services.

Shavers filed a general denial, and Lorenz did not amend his initial general denial. The trial court rendered a judgment in favor of the plaintiff after a bench trial. On appeal, Lorenz complained that the trial court erred in finding Lorenz and Shavers participated in a partnership. Because the Texas Rules of Civil Procedure require that the denial of a partnership must be raised by a verified denial, the court of appeals held that the existence of the partnership could not be controverted at trial. Lorenz argued that he sufficiently denied the partnership status in his verified special appearance, but the court of appeals stated that the denial of a partnership in a special appearance does not satisfy the requirement of Rule 93(5). Finally, the court rejected Lorenz's argument that the existence of the partnership was tried by consent. The president of the plaintiff testified that Lorenz represented to him that Lorenz and Shavers were partners with Shavers in Jesco Disaster Services. When Lorenz cross examined the plaintiff's president on the partnership issue, the plaintiff objected to testimony or attempts to establish there was no partnership and called the court's attention to the absence of a sworn denial of partnership. The trial court overruled the objection, and the plaintiff obtained a running objection. The court of appeals held that the issue was not tried by consent and found that the evidence was sufficient to support the trial court's finding that Lorenz and Shavers participated in a partnership.

Burt v. Harwell, __ S.W.3d __, 2012 WL 1650372 (Tex. App.–Dallas 2012, no pet. h.).

Gary Burt sued Asphalt Cowboys and its alleged partners Richard Reek and Larry Harwell in connection with work on a driveway that Burt hired Asphalt Cowboys to do. Harwell filed a verified denial swearing that he did not contract with Burt, had never done business as Asphalt Cowboys, and was not in a partnership with any of the defendants. Harwell filed a no-evidence summary judgment motion, and the trial court granted the motion. On appeal, Burt argued that he raised a fact issue as to the existence of a partnership. The court of appeals concluded that Burt failed to raise a fact issue on partnership because his response referred only generally to an appendix containing affidavits and discovery and did not direct the trial court to any specific summary judgment evidence to establish a partnership. Additionally, the only evidence Burt cited on appeal consisted of exhibits attached to Richard Reek's motion for summary judgment. Reek's response did not reference and did not purport to reference any evidence showing Harwell was a partner, and the court of appeals thus declined to consider evidence attached to that response.

Malone v. Patel, __ S.W.3d __, 2012 WL 1142251 (Tex. App.–Houston [1st Dist.] Apr. 5, 2012, no. pet. h.).

Firdosh Patel sued Edward Malone alleging that Malone reneged on their agreement to form a partnership for a consulting business called Prescendo Consulting, LP ("Prescendo") in which they and Meng Choo would be equal partners. Patel emigrated from India in 1994 and earned an MBA from Rice. He worked for many years in the energy sector while seeking permanent residency, which he obtained in December 2004. His immigration status was cited as a reason why the parties' disputed business relationship was not documented in writing earlier. In December 2003, Patel signed a letter accepting a low salary as an at-will employee of Prescendo with the possibility of a merit-based bonus dependent on Prescendo's overall performance. According to Patel, Malone told him that his ownership could not be documented in writing until his green card was finalized. Patel testified that he understood that he was an employee but that the agreement he had with Malone was to own one-third of Prescendo with Malone and Choo. Several documents introduced at trial reflected Malone as 100% owner of Prescendo. The three agreed to hire an employee and split up the start-up and ongoing responsibilities at Prescendo. In 2004, the three agreed to raise Patel's salary, and in December Patel received his green card. Over the next year and a half Patel and Choo asked Malone about putting their partnership agreement in writing, but no writing was ever produced. In September 2006, the dispute over ownership of Prescendo that led to the litigation occurred. Patel reminded Malone about reducing their agreement to writing, and Malone responded that they needed to create a spreadsheet to determine what percentage of ownership he, Patel, and Choo would own. Patel demanded to know why a spreadsheet was needed when the three had always agreed that each owned a one-third interest in Prescendo. Malone informed Patel and Choo that he considered them at-will employees and not partners. Malone made a proposal regarding dividing past retained earnings and considering future ownership; however, the relationship deteriorated and Patel resigned from Prescendo in November 2006. At trial, Patel argued that he and Malone had agreed since its inception to be equal partners in Prescendo but that Malone had represented that until Patel secured a green card they could not put their agreement in writing because Patel was prohibited from owning equity. Malone contended that an agreement to be equal partners never existed and that Patel was an at-will employee who had been told he may be granted some ownership in the business in the future. The jury found that Patel and Malone had agreed that they would be equal partners in Prescendo together with Choo and awarded Patel $495,000 as damages for the amount of money Patel would have received as an equal partner in Prescendo less the value of what he was paid. The trial court entered judgment on the jury finding that the parties had formed a partnership and awarded Patel damages.

On appeal, Malone argued that the evidence was legally and factually insufficient to prove that Malone and Patel were partners. Instead, Malone asserted that the trial court's judgment should be reversed because the evidence

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