

# **JOINT VENTURE GOVERNANCE AND BUSINESS OPPORTUNITY ISSUES**

**By**

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## Appendix A – Egan on Entities

# JOINT VENTURE AND BUSINESS OPPORTUNITY GOVERNANCE ISSUES

BY

BYRON F. EGAN\*

## I. INTRODUCTION

The joint venture is a vehicle for the development of a business opportunity by two or more entities acting together,<sup>1</sup> and will exist if the parties have: (1) a community of interest in the venture, (2) an agreement to share profits; (3) an agreement to share losses, and (4) a mutual right of control or management of the venture.<sup>2</sup> A joint venture may be structured as a corporation, partnership, limited liability company (“**LLC**”), trust, contractual arrangement, or any combination of such entities and arrangements.<sup>3</sup> Structure decisions for a particular joint venture will be driven by the venturers’ tax situation, accounting goals, business objectives and financial needs, as well as the venturers’ planned capital and other contributions to the venture, and antitrust and other regulatory considerations.<sup>4</sup> Irrespective of the structure chosen, however, certain elements are typically considered in connection with structuring every joint venture.

Because a joint venture is commonly thought of as a limited duration general partnership formed for a specific business activity, the owners of a joint venture are sometimes referred to herein as “**partners**” or “**venturers**,” and the joint venture as the “**entity**,” “**partnership**” or “**venture**,” in each case irrespective of the particular form of entity or other structure selected for

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<sup>1</sup> See Byron F. Egan, *Joint Venture Formation*, 44 Tex. J. Bus. Law 129 (2012); James R. Bridges and Leslie E. Sherman, *Structuring Joint Ventures*, 4 Insights 17 (Oct. 1990); David Ernst and Stephen I. Glover, *Combining Legal and Business Practices to Create Successful Strategic Alliances*, 11 Insights 6 (Oct. 1997); Stephen I. Glover, *Joint Ventures and Opportunity Doctrine Problems*, 9 Insights 9 (Nov. 1995); Warren S. de Wied, *Structuring Strategic Equity Investments*, 1 No. 8 M&A Law. 7 (Jan. 1998).

<sup>2</sup> *Pitts & Collard, L.L.P. v. Schechter*, No. 01-08-00969-CV, 2011 WL 6938515, at \*11 (Tex. App.—Hous. [1st Dist.] Dec. 29, 2011). For additional discussion of whether the agreement is, in fact, a joint venture, see *id.* at \*11-12.

<sup>3</sup> See JOINT VENTURE TASK FORCE OF NEGOTIATED ACQUISITIONS COMMITTEE, MODEL JOINT VENTURE AGREEMENT WITH COMMENTARY (Am. Bar Ass’n., 2006) (the “**ABA Model Joint Venture Agreement**”).

<sup>4</sup> See Byron F. Egan, *Choice of Entity Decision Tree*, TexasBarCLE and Business Law Section of State Bar of Texas program on Choice and Acquisition of Entities in Texas, May 22, 2015, available at <http://www.jw.com/publications/article/2054> (“**Business Entities Paper**”) at pages 49, 430-436.

the joint venture. Today the LLC is typically the entity of choice for the formation of a joint venture because, as discussed below, it offers structuring flexibility and limited owner liability for joint venture activities under both the Texas Business Organizations Code (“*TBOC*”), which now governs all LLCs formed under Texas law,<sup>5</sup> and the Delaware Limited Liability Company Act (the “*DLLCA*”).<sup>6</sup>

## II. CHOICE OF ENTITY

### A. *Alternatives*

A joint venture may take the form of:

(1) Contractual Relationship Not Constituting an Entity Recognized by Statute. The joint venturers may operate under a relationship such as a contractual revenue-sharing joint venture, a lease, a creditor/debtor relationship or some other relationship not constituting an entity. A risk to this structure is that a court will impose general partnership duties or liabilities on the venturers if their relationship is found to constitute “an association of two or more persons to operate a business as co-owners for a profit” (the traditional definition of a partnership) regardless of how the venturers characterize and document their relationship.<sup>7</sup> In determining whether the relationship is a partnership, the following factors are considered:

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<sup>5</sup> LLCs formed under Texas law are now governed by Title 3 and pertinent provisions of Title 1 of the TBOC. TBOC §§ 401.001, 402.003. The TBOC provisions applicable to LLCs may be officially and collectively referred to as “Texas Limited Liability Company Law.” TBOC § 1.008(e).

<sup>6</sup> Del. Code Ann. tit. 6 § 18-101 *et. seq.*

<sup>7</sup> In *Dernick Resources, Inc. v. Wilstein, et al*, 312 S.W.3d 864, 877 (Tex. App.—Houston [1st Dist.] 2009, no pet.), which involved an oil and gas drilling and production arrangement pursuant to a contract that was called a “joint venture agreement,” the court in an opinion by Justice Evelyn Keyes held that the joint venture agreement created a fiduciary relationship that imposed a fiduciary duty of full and fair disclosure on the managing venturer as it held title to the venture’s properties in its name and had a power of attorney to dispose of the properties, and explained:

Joint venturers for the development of a particular oil and gas lease have fiduciary duties to each other arising from the relationship of joint ownership of the mineral rights of the lease. [citation omitted] Likewise, if there is a joint venture between the operating owner of an interest in oil and gas well drilling operations and the non-operating interest owners, the operating owner owes a fiduciary duty to the non-operating interest owners. [citation omitted] In addition, “[a]n appointment of an attorney-in-fact creates an agency relationship,” and an agency creates a fiduciary relationship as a matter of law. [citation omitted] The scope of the fiduciary duties raised by a joint venture relationship, however, does not extend beyond the development of the particular lease and activities related to that development.

The dispute revolved around the manager’s sale of parts of its interest after giving oral notice to the other venturer, but not the written notice accompanied by full disclosure specified in the agreement. The opinion is lengthy and very fact specific, but the following lessons can be drawn from it: (i) calling a relationship a joint venture can result in a court categorizing the relationship as fiduciary, which in turn implicates fiduciary duties of candor and loyalty and could implicate the common law corporate opportunity doctrine (which is part of the fiduciary duty of loyalty), (ii) it is important to document the relationship intended (an LLC could be used as the joint venture entity and the LLC company agreement could define, or in Delaware eliminate, fiduciary duties), and (iii) written agreements should be understood and followed literally.

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