

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

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

Elizabeth S. Miller

I. Introduction

This paper summarizes recent Texas cases involving issues of partnership and limited liability company law. This paper only includes cases that have appeared since the paper for last year's program was prepared. Case law surveys that include cases from prior years are available on the author's profile page at the Baylor Law School web site.

II. Recent Texas Cases Involving Partnerships

A. Creation/Existence of General Partnership

Phillips v. Boo 2 You, LLC, No. 03-14-00406-CV, 2016 WL 2907971 (Tex. App.—Austin May 13, 2016, no pet. h.) (mem. op.).

The court of appeals affirmed a summary judgment against an individual who alleged the creation of a partnership with the defendant. The court also upheld sanctions based on the plaintiff's "fanciful" damages claim and harassing discovery.

Gary Phillips sued George Steven Smith and Linda Smith, husband and wife, and Boo 2 You, LLC ("Boo") alleging that the parties created a partnership and entered into an agreement relating to the operation of a business selling Halloween products. Phillips asserted that the defendants failed to distribute to him his share of the profits in breach of the partnership agreement. The defendants prevailed on a motion for summary judgment in which they asserted that there was no evidence of one or more of the statutory factors that indicate formation of a partnership.

The defendants' summary judgment proof showed that Boo, an LLC, was a seasonal business that sold Halloween merchandise on consignment. Steven Smith was the managing member of Boo, and Linda, who was not a member, helped him operate the business. For at least two Halloween seasons, Phillips had lent money to Boo for its annual operations. The loans were repaid with interest. In 2010, Phillips inquired about becoming a member of Boo. Smith did not agree to this request, but offered Phillips an opportunity to share profits in three of Boo's stores for the upcoming Halloween season provided that Phillips pay one-half of the expenses and participate in the operation of those stores throughout the Halloween season. Phillips contributed one-half of the expenses of the three stores but failed to help in their operation throughout the season. Thus, Boo did not share profits from the operation of those stores with Phillips. Boo repaid Phillips \$80,000 with interest for the loans that he had made to Boo for the 2010 season.

In his response to the defendants' motion for summary judgment, Phillips relied on a Letter of Understanding (LOU) entered into by the parties in March of 2010. The letter stated that the parties had agreed to open additional Halloween stores and referred to a partnership between the parties as follows: "The partnership between the parties has been agreed to provide for a 50/50 split in the net proceeds of the above mentioned stores. This shall require both parties to equally share in the expenses of opening such stores." The letter also described the tender of \$5,000 by Phillips to pay one-half of a consignment deposit required to be paid to the franchisor.

Phillips appealed the trial court's summary judgment against him, and the court of appeals analyzed the summary judgment evidence in light of the statutory five-factor test for determining if a partnership has been created. In Texas, a general partnership is an association of two or more persons to carry on a business for profit as owners, regardless of whether the persons intend to create a partnership or whether the association is called a "partnership." Tex. Bus. Orgs. Code § 152.051(b). Factors indicating that persons have created a partnership include: (1) receipt or right to receive a share of the profits of the business; (2) expression of an intent to be partners in the business; (3) participation or right to participate in control of the business; (4) agreement to share or sharing losses of the business or liability for claims by third parties against the business; and (5) agreement to contribute or contributing money or property to the business. Tex. Bus. Orgs. Code § 152.052(a). The Texas Supreme Court has adopted a totality-of-the-circumstances test for applying the factors. The court of appeals analyzed the evidence of each factor and concluded that Phillips failed to raise fact issues with respect to four of the five statutory factors.

With respect to the first factor, the Smiths argued that the profit-sharing agreement was not based upon Phillips's co-ownership of the business, but instead upon his performance of work at the stores for the Halloween season. However, Phillips summary judgment proof indicated that he did not have a commitment to work at the stores and was only working there for “fun” to pass the time. Thus, the court concluded that the summary judgment record raised a genuine issue of fact as to this factor.

With respect to the second factor, Phillips relied primarily upon the LOU to establish that the parties intended to form a partnership. The court pointed out that the Texas Supreme Court has said that the intent factor is distinct from the other four factors and must depend on evidence that is not specifically probative of other factors. The court stated that this principle precluded Phillips from relying on the LOU to demonstrate intent because he relied on it to demonstrate the right to receive a share of the profits of the business. Phillips offered no summary judgment proof that the parties referred to each other as partners, held themselves out as partners, or had stationery, letterhead, business cards, or a bank account for the claimed partnership. There was no summary judgment proof that the parties discussed or used the word “partnership” to describe their relationship other than the conclusory, non-probative deposition testimony of Phillips regarding the execution of the LOU and the single mention of “partnership” in the LOU. Thus, the court concluded that there was no summary judgment proof that the parties expressed an intent to be partners in the business.

There was no evidence of the third factor because Phillips admitted in his deposition that he had no control or managerial authority. The court noted that sharing control and sharing profits are generally considered the most important factors in establishing the existence of a partnership.

With respect to the fourth factor, Phillips tried to characterize his loans to Boo as his risk of loss, but the court stated that there was no summary judgment proof that the parties discussed losses or liabilities for claims by third parties, much less agreed that Phillips's loan of \$80,000 for expenses would cap his exposure for losses.

With respect to the fifth factor, the court stated that Phillips's loans, viewed in isolation, might be regarded as partnership contributions, but the court stated that it must look at the loans in the context of the totality of the circumstances. The \$80,000 lent by Phillips for the operation of the business in 2010 was repaid along with 12% interest in less than a year. Phillips characterized the \$80,000 loan as a “capital contribution” with no further explanation or authority. Phillips and the Smiths had a history of a lender-borrower relationship before 2010, and the money lent in 2010 and its repayment with interest were entirely consistent with their past lender-borrower pattern. The funds lent by Phillips appeared less like a contribution from a partner and more like a loan from a lender. Thus, the court concluded that the summary judgment proof did not raise a genuine fact issue on this factor.

In sum, the court found that the only factor as to which Phillips raised a fact issue was an agreement to share profits, and the summary judgment proof was inconsistent with the proposition that Phillips and the defendants formed a partnership. Thus, under the totality-of-the-circumstances test the court concluded that the summary judgment proof failed to raise a genuine issue of fact as to the existence of a partnership. The court of appeals also upheld an order of the trial court sanctioning Phillips by requiring him to pay the defendants \$10,000 in attorney's fees and costs for filing the suit, which the trial court found to be “frivolous and vexatiously prosecuted for the purposes of harassment.” The court of appeals pointed out that the damages sought by Phillips included \$6,250 for the “useful life” of shelves that the defendants had purchased with money that Phillips had lent them even though the loan had been fully repaid with interest. The court stated that Phillips had no legitimate claim to property purchased with funds from his loan. In addition, the court of appeals noted several discovery hearings that were held regarding attempts by Phillips to obtain in discovery the defendants' financial records reflecting transactions occurring after the time period involved in the lawsuit. Phillips did not defend his damages theory or dispute the discovery hearings, and the court of appeals concluded that the sanctions were not an abuse of discretion by the trial court in light of “the fanciful damage claim (the shelves) and the history of Phillips's harassing discovery battles.”

In re Springwoods Joint Venture, No. 15–32751, 2016 WL 2343028 (Bankr. S.D. Tex. Apr. 29, 2016).

The court concluded that fact issues precluded summary judgment on the issue of whether the debtor in this involuntary bankruptcy proceeding was a partnership.

R. Hassell Holding Company, Inc. (“RHHC”) filed an involuntary petition against Hassell 2012 Joint Venture and Springwoods Joint Venture. In contrast to a typical involuntary petition filed by one or more creditors, the petition was filed by RHHC in its capacity as a general partner of the alleged debtors. In response to motions to dismiss the involuntary petition by several parties, the court issued an opinion in which it determined that Hassell

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