

**AMBIGUOUS, OMITTED AND INCONSISTENT PROVISIONS IN PARTNERSHIP AND
COMPANY AGREEMENTS**

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**UTCLE
LLCs, LPs AND PARTNERSHIPS**

**July 22-24, 2020
Live Webcast**

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I. SCOPE OF ARTICLE. This paper is intended to provide an overview of common pitfalls and drafting issues in LLC operating agreements [and partnership agreements], with references to relevant statutory provisions and case law; however, it is not intended to be an exhaustive treatment of LLC law [or partnership law] in general and drafting matters in LLC operating agreements [and partnership agreements] specifically. On tax matters, there is an even briefer treatment. Where appropriate, drafting issues or suggestions peculiar to LLCs [or partnerships] are identified as such.

II. BACKGROUND.

A. Applicable Authorities; Source Materials.

1. Statutes. The following statutes are discussed, or are relevant to the discussion contained, in this paper:

a. LLC Statute. The Texas Business Organizations Code, Title 3 (hereinafter, "**TBOC LLC Laws**"), applies to Texas limited liability companies. The TBOC LLC Laws govern all limited liability companies to the extent not inconsistent with the operating agreement of the applicable limited liability company.

b. Partnership Statute. The Texas Business Organizations Code, Title 4 (hereinafter, "**TBOC Partnership Laws**" and together with the TBOC LLC Laws, the "**Texas Laws**"), applies to Texas partnerships. The TBOC Partnership Laws govern all partnerships to the extent not inconsistent with the partnership agreement of the applicable partnership.

c. Delaware Statute. Because of perceived beneficial differences between Delaware law and Texas law, it is not uncommon for owners of Texas business entities to organize under the Delaware limited partnership or limited liability company statutes. In fact, there are very few substantive differences between the two states' LLC and limited partnership laws. A discussion of the remaining differences between the two laws is beyond the scope of this paper.

B. The Importance of Thoughtful Drafting. One of the hallmarks of using the LLC or partnership form is its flexibility. Subject to public policy limitations, in the extreme, there are very few results that would flow from the Texas Laws that cannot be varied by agreement of the partners or members, as applicable. Texas courts have strongly endorsed the primacy of contract notion in seeking to give effect to the agreement of partners as expressed in their LLC agreement or partnership agreement. For example, in Park Cities Corporation v. Byrd, 534 S.W.2d 668 (Tex. 1976), the Texas Supreme Court stated:

"The agreement of the parties is to be controlling of our decision and we shall construe and interpret their agreement pursuant to the applicable law of contracts.... We look to the [Texas Uniform Partnership Act]¹ for guidance only when the partnership agreement is silent. In this case we shall often consider it only as an interpretive aid."

¹ The provisions of the Texas Uniform Partnership Act are incorporated in the TBOC.

Id. at 672. See also Hoagland v. Finholt, 773 S.W.2d 740 (Tex. App. - Dallas 1989, no writ). In fact, one of the principal goals of the Texas Laws was contractual flexibility – the structure and governance of the partnership or LLC, as applicable, is largely controlled by agreements among the owners (e.g. “freedom of contract”) rather than specifying rules in the statute like the corporation statutes. With respect to LLCs and partnerships, the Texas Laws are only applicable to the extent the parties have not addressed the particular issues in their LLC operating or partnership agreement. Best practices include a written, company-specific and comprehensive operating or partnership agreement that is signed by all of the company’s owners and governing persons. Although partnership agreements may be oral under the TBOC, the disadvantages of relying on an oral agreement are obvious.

Clearly, the Texas Laws place a premium on thoughtful drafting to cover the parties' agreement. It is important to know (i) what the parties desire, (ii) what the statutes and cases say, and (iii) what results flow from silence. For example, TBOC Sections 11.151 and 153.501(d) allow for the partnership agreement to provide for continuation after dissolution, without the unanimous consent that otherwise would be required. In addition, TBOC Section 153.103 provides that a limited partner does not participate in control of the business (and thereby have liability as a general partner) by virtue of his proposing, approving or disapproving, by vote or otherwise "... *any [other] matter stated in the partnership agreement.*" Thus, a limited partner may be entitled to propose or approve just about any partnership action without losing limited liability, as long as it is expressly stated in the partnership agreement.

C. Drafting Flexibility. The TBOC is pretty specific on the subject of drafting flexibility. As important as freedom of contract is in connection with partnerships and LLCs, there are a few limits. TBOC Sections 101.054 and 153.009 list statutory provisions applicable to LLCs and partnerships, as applicable, that cannot be varied by agreement. Such provisions are as follows:

1. May not unreasonably restrict a *partner's* or *member's* right of *access to books and records* under Sections 3.151, 101.501 and 153.009. Other information rights in Sections 3.151, 101.501 and 153.009, as applicable, are variable by agreement.

2. TBOC Sections 3.151, 101.501 and 153.009 also address the fiduciary duties of the members or partners, as applicable, which is a fundamental core of member and partner responsibility, and may not be waived entirely:

- a. May not eliminate the *duty of loyalty* but may specify activities that do not violate the duty of loyalty, if not manifestly unreasonable;
- b. May not eliminate the *duty of care* but may determine standards by which performance is measured, if the standards are not manifestly unreasonable; and
- c. May not eliminate the obligation of *good faith* but may determine the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable.

3. May not vary the *power to withdraw* as a partner under Sections 152.501(b)(1), (7), or (8), except to require that notice be in writing.

4. May not vary the *right to expel* a partner (which is an *event of withdrawal* of the expelled partner) *by court order* under certain conditions specified by Section 152.501(b)(5) (*i.e.* the partner

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First appeared as part of the conference materials for the 29th Annual LLCs, LPs and Partnerships session

"Ambiguous, Omitted, and Inconsistent Provisions in Partnership and Company Agreements: Approaches and Examples (Plus Bonus Discussion: Force Majeure in Texas)"