

**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

Thunder Rose Enters., Inc. v. Kirk, No. 13-15-00431-CV, 2017 WL 2172468 (Tex. App.–Corpus Christi Apr. 20, 2017, no pet. h.)(mem. op.).

The court of appeals upheld a jury's verdict that an oral partnership existed between the parties.

Billy Kirk filed suit in September of 2011 alleging that he had formed a partnership with Michael Palmer and that Palmer had breached his duty of loyalty to Kirk. Later, Kirk added claims for breach of contract and requested a declaratory judgment that a partnership existed. Palmer disputed that there was a partnership, and alleged that if a partnership existed, Kirk breached his fiduciary duties owed to the partnership. Thus, a central issue at trial was whether Palmer and Kirk had formed a partnership.

Palmer invented a component part to be used in the oil and gas industry. In 2008, Palmer approached Kirk in an effort to obtain financing and market the valve. In 2009, Palmer and Kirk met with a manufacturer and contracted to have the manufacturer build a prototype of the product. As part of that transaction all parties other than Palmer signed a nondisclosure agreement. Kirk and a business associate had discussions about forming an entity, Excalibur Control Systems ("Excalibur"), to own the license to produce and market the valve. Kirk established a bank account in the name of Excalibur and advanced funds through Excalibur to pay for the prototype. Kirk and his business associate never signed the draft agreement prepared by Kirk regarding the formation of Excalibur, and Kirk and that business associate later severed their ties.

Palmer proposed that Excalibur be owned jointly by Kirk and Palmer and that Kirk contribute cash into Excalibur. Kirk did not have cash on hand and was unsuccessful in obtaining a bank loan. Despite the lack of financing or clear agreement regarding the structure, the parties continued with development. In 2010, the parties contracted with a different manufacturer to have a second prototype developed and, once completed, Palmer began making repairs on the second prototype. Palmer alleged that Kirk ordered additional valves and attempted to sell them without Palmer's knowledge or approval.

In 2011, Kirk's attorney sent to Palmer's attorney a draft agreement to form a Delaware LLC, which would own the patent, trademark, and distribution rights on the product. Under the proposed agreement Kirk would contribute \$750,000 and Palmer would contribute his rights to the product. That agreement was never executed. Palmer countered by offering Kirk a non-exclusive license to develop and market the product. After a few days, Palmer sent Kirk a cease and desist letter demanding that Kirk cease marketing the product. Kirk filed suit two weeks later.

At trial, the jury found there was an oral partnership agreement between the parties and that the agreement contained the following terms: (1) Kirk was to supply financing and funding for the development and production of the valve; (2) the parties were to split profits from the sale and marketing of the valve equally, with Kirk recouping his expenses from his 50% share; (3) the parties were to share losses and liability to third parties from the valve equally; and (4) Palmer was to assign Kirk an exclusive worldwide right or license to sell and market the valve. The jury found that Palmer breached each of these terms. The jury also found that Palmer breached the agreement by issuing the cease and desist letters and by preventing third parties from doing business with the partnership. The trial court rendered judgment on the verdict and ordered the parties to specifically perform under the partnership agreement. This appeal followed.

Palmer first challenged the sufficiency of the evidence to support the finding that there was an oral partnership agreement. The court cited the statutory description of a “partnership” as “‘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’ and regardless of what the association is called.” Tex. Bus. Orgs. Code §152.051(b). The following five statutory factors are considered in determining whether a partnership has been created: (1) receipt or right to receive a share of 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). Whether a partnership exists must be determined by an examination of the totality of the circumstances.

The court first discussed testimony by Kirk and his lawyer about the agreement between Kirk and Palmer. Kirk testified that he and Palmer had a lengthy conversation in 2008 in which Palmer stated that Palmer wanted Kirk to be his partner, and in which they agreed on the terms of their partnership. These terms included the following: that Kirk would finance the operation and Palmer would provide the exclusive rights to manufacture, market, and distribute the valve; that profits and losses would be shared 50-50; and that they would share control equally. Additionally, Kirk’s attorney testified that Palmer and Kirk held each other out as partners, that they shared control equally, that they both made contributions to the partnership, and that they agreed to share profits and losses equally. The court agreed with Kirk that this testimony addressed the five statutory factors and was alone sufficient to allow the jury to conclude that a partnership agreement was reached.

In addition to the testimony regarding the agreement reached by Kirk and Palmer, the court pointed to evidence that they in fact shared control and each contributed thousands of dollars to the business. Furthermore, there was evidence that Palmer held Kirk out to be his partner with respect to the development and marketing of the valve, thus bolstering the evidence of intent to form a partnership reflected in the testimony of Kirk and Kirk’s lawyer.

In support of his argument that there was no partnership, Palmer pointed to the absence of profits generated from any sales of the valves and the absence of any mechanism to distribute profits, such as a line of credit or bank account, as well as the absence of accounting records, tax records, jointly titled property, or other financial records indicating the existence of a partnership. However, the court pointed out that there was evidence that Kirk set up a bank account in the name of Excalibur with Palmer, Kirk, and Kirk’s former business associate listed as signatories. The court stated that it must assume that the jury disbelieved evidence that supported the inference that there was not a partnership.

Palmer emphasized that the parties were never able to reach an agreement as to a patent license, but the court stated that the failure to enter into a written agreement as to a license did not preclude a finding that they separately agreed orally to be partners. Palmer pointed to statements in the nondisclosure agreement and draft LLC agreement that the parties did not intend to establish a partnership, but the court again stated the jury was entitled to reject this evidence. The jury could have instead believed Kirk’s explanation that the negotiations to create the LLC and to grant intellectual property licenses to that entity constituted an effort to convert the existing partnership into an LLC.

Considering the totality of the circumstances in light of the five statutory factors, the court concluded that the evidence could enable a reasonable juror to find that a partnership agreement existed, and the evidence was not so weak as to make the verdict clearly wrong or unjust.

Lopez v. Hernandez (In re Hernandez), 565 B.R. 367 (Bankr. W.D. Tex. 2017).

The court determined that the parties formed a “de facto” partnership and that one of the parties breached the fiduciary duty he owed to his fellow partner.

Hernandez and Quiroz-Pedrazzi formed a Texas LLC to purchase OrangeCup frozen yogurt stores in Texas and to purchase intellectual property rights and assets for the stores. Hernandez showed Lopez the business plan to open five OrangeCup stores and discussed the stores’ finances. In 2012, Lopez, Hernandez, and Quiroz-Pedrazzi signed a subscription agreement stating Lopez would pay \$400,000 for a 20% membership interest in the LLC if Hernandez gave Lopez financial documentation for the LLC and a related entity. Although Lopez did not receive the financial information, she paid \$200,000 and received a promissory note. Lopez continued to ask for the financial information and made numerous additional loans or contributions in 2012 and 2013. Lopez deferred taking a formal membership interest in the LLC while she awaited the requested financial information. Hernandez never

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