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Provisions Limiting Constituent Liabilities and Duties in Partnership and Company Agreements

Christine Hurt, Brigham Young University - Provo, UT

Robert R. Keatinge, Holland & Hart LLP - Denver, CO

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This panel will discuss the effectiveness and limitations on provisions of partnership and company agreements which provide for the modification of duties, exoneration from liability and indemnification with respect to claims against managers, members and other employees and agents.

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I. Introduction

Under most business organization law, shareholders, partners or members or other equity owners of organizations (collectively, “owners”) and decision-makers and statutory agents of organizations (directors, officers, general partners [of LLPs and LLLPs], members, and managers) and other agents and employees of the organization (collectively “agents,” and collectively with owners, “constituents”) are not vicariously liable for the debts, obligations, or liabilities the organization (collectively “organizational obligations”). The principal exceptions to this principle relate to: (1) statutory vicarious liability of general partners of partnerships which have not elected to be LLPs or LLLPs;¹ (2) statutory liability of owners for specific organizational obligations such as environmental² or some tax³ obligations; (3) common law piercing-the-veil principles;⁴ and (4) individual obligations contractually undertaken by owners such as guarantees.

¹ This liability may include obligations of owners and agents such as those of professionals either by virtue of their being owners or by virtue of their acting in their agent capacity.

² See, e.g., CERCLA operator liabilities.

³ Some states impose obligations on owners or other constituents for unpaid trust fund, sales tax, or workers compensation taxes.

⁴ *MCR OilTools, LLC v. SPEX Offshore, Ltd.*, Civ. A. No. 3:18-cv-00731-M, 2018 WL 4362695 (N.D. Tex., Sept. 13, 2018).

“The Court notes that the requested business and organizational documents sought by MCR are relevant and discoverable under Texas alter ego law. Presumably, Texas law will govern whether the corporate veil of SPEX Group, a Texas limited liability company, will be pierced. See Tex. Bus. Orgs. Code § 1.104; see also *Alberto v. Diversified Grp., Inc.*, 55 F.3d 201, 204 (5th Cir. 1995); *Davaco, Inc. v. AZ3, Inc.*, No. 3:07-CV-803, 2008 WL 2243382, at *1 (N.D. Tex. May 30, 2008) (“[A] choice of law provision in a contract does not alter the rule that the law of the state of incorporation governs the alter ego analysis.”). Under Texas law, factors demonstrating an alter ego relationship include ‘the degree to which corporate formalities have been followed and corporate and individual property have been kept separately, the amount of financial interest, ownership and control the individual maintains over the corporation, and whether the corporation has been used for personal purposes.’ *Castleberry v. Branscum*, 721 S.W.2d 270, 272 (Tex. 1986).”

Similarly, agents are generally not individually liable to third parties, the organization, or agents for actions taken or decisions made on behalf of the organization. The principal exceptions to this principle relate to: (1) actions by agents which violate statutory, common law, or contractual duties (including duties of loyalty, care, owed by the agents as such to the organization or the other owners; (2) statutory and common law liability of owners to either the organization (or sometimes creditors of the organization) for failure to make agreed-upon contributions or receipt of wrongful distributions; (3) actions by agents on behalf of the organizations which violate independent duties owed by the agent to a third party; and (4) individual obligations contractually undertaken by owners such as guarantees.

This outline does not attempt to cover all elements of these liabilities of owners and agents (collectively “constituents”) but merely explores the effect of some provisions in partnership agreements and company agreements (collectively “governing agreements”)⁵ on the liabilities of constituents. A governing agreement may address claims As a general proposition, the governing agreements are not effective to limit the liability of constituents to persons other than the organization and other constituents (“third parties”).⁶ The organic agreement may provide for indemnification of and advancement to a constituent with respect to claims against a constituent individually.⁷

II. Choice of Law

A. Internal Affairs

⁵ See, Tex. Bus. Orgs. Code §1.002(36)(A).

⁶ See, Tex. Bus. Orgs. Code §101.054. (d) (“A provision in this title or in that part of Title 1 applicable to a limited liability company that grants a right to a person, other than a member, manager, officer, or assignee of a membership interest in a limited liability company, may be waived or modified in the company agreement of the company only if the person consents to the waiver or modification.”)(e) The company agreement may not unreasonably restrict a person's right of access to records and information under Section 101.502.

⁷ Tex. Bus. Orgs. Code §Sec. 8.002(b) (“The governing documents of a general partnership or limited liability company may adopt provisions of this chapter or may contain other provisions, which will be enforceable, relating to: (1) indemnification; (2) advancement of expenses; or (3) insurance or another arrangement to indemnify or hold harmless a governing person.”).

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